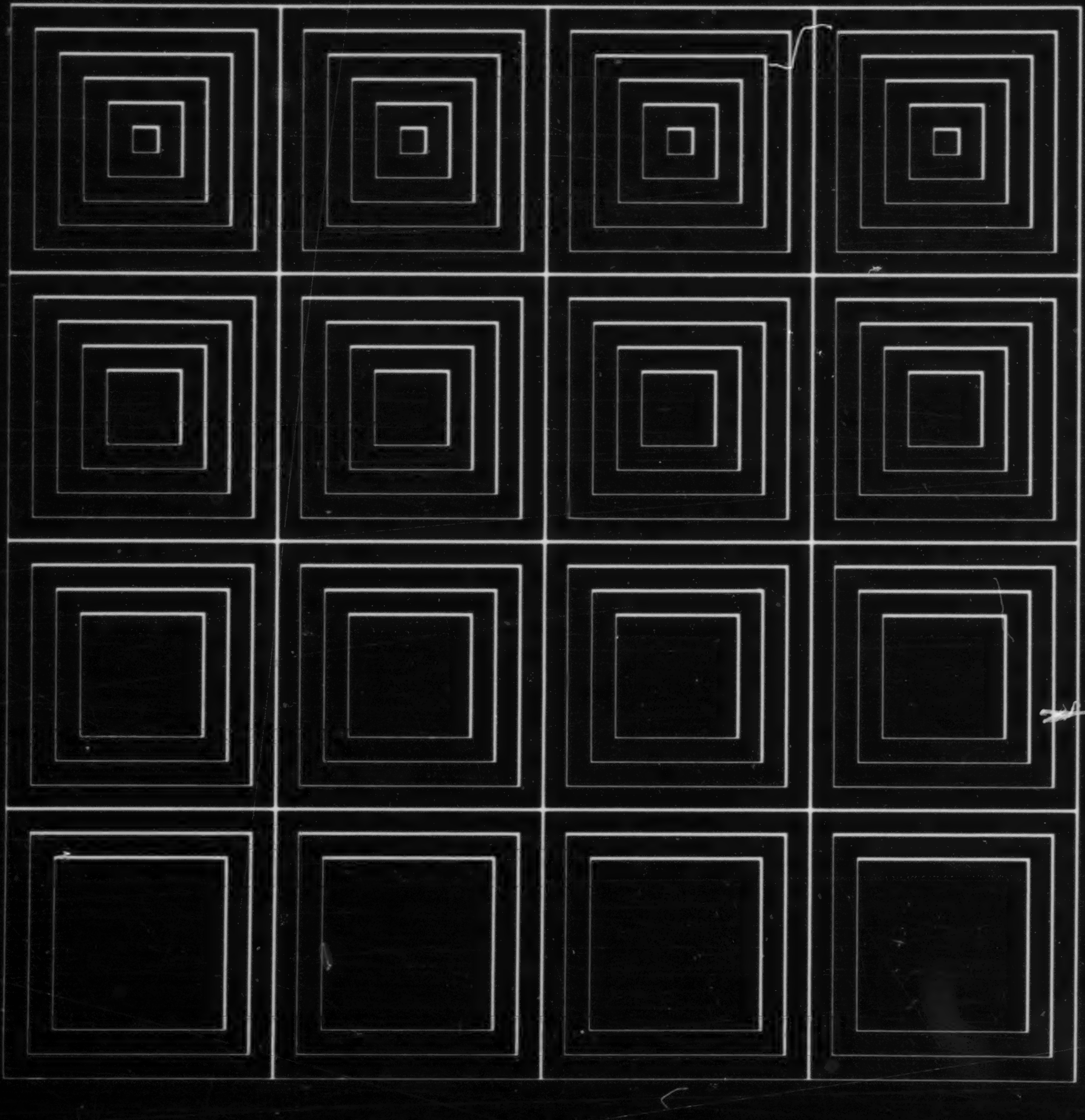
Report of the

Auditor General of Canada

to the House of Commons



Fiscal Year Ended 31 March 1987

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90-04726/

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Cat. No. FA1-1987E

ISBN 0-662-15695-1

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AUDITOR GENERAL OF CANADA
VÉRIFICATEUR GÉNÉRAL DU CANADA

To The Honourable the Speaker of the House of Commons:

I have the honour to transmit herewith my Report to the House of Commons for the fiscal year ended 31 March 1987, to be laid before the House in accordance with the provisions of section 7(3) of the Auditor General Act, S.C. 1976-77, c. 34.

Kenneth M. Dye, F.C.A.
Auditor General of Canada

OTTAWA, 21 October 1987

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INTRODUCTION

REPORT OF THE AUDITOR GENERAL
TO THE HOUSE OF COMMONS
FOR THE FISCAL YEAR ENDED 31 MARCH 1987

INTRODUCTION

The principal functions and responsibilities of the Auditor General of Canada are set out in the Auditor General Act, S.C. 1976-77, c. 34, which came into force 1 August 1977. My responsibilities in respect to those Crown corporations for which I have been appointed auditor are set out in the Financial Administration Act, R.S.C. 1970, c. F-10 (amended). The Auditor General Act is included as Appendix A to this Report and the relevant sections of the Financial Administration Act as Appendix B.

The financial statements of the Government of Canada for the fiscal year ended 31 March 1987, which have been prepared by the Receiver General for Canada in accordance with the provisions of section 55 of the Financial Administration Act and appear in Volume I of the Public Accounts of Canada, have been examined by me as required by section 6 of the Auditor General Act.

In compliance with section 7 of the Auditor General Act, my Report for the fiscal year ended 31 March 1987 is presented herewith.

As auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund, I conducted such examinations and inquiries as I considered necessary to enable me to report as required by the Auditor General Act.

Departments and agencies and the Privy Council Office provided my Office with the information and explanations required to date, including Cabinet documents. However, in several instances, the provision of information to my Office was subject to significant delays.

My examination of the acquisition of Petrofina Canada Inc. by the Government of Canada for at least $1.7 billion remains incomplete. The Trial Division of the Federal Court ruled that my Office was entitled to the information we requested. The majority of the Court of Appeal reversed the decision of the Federal Court. The matter is now before the Supreme Court of Canada.

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

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1

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

Financial Management and Control Study

1.1 More than any of its predecessors this, my seventh annual Report, brings good news and bad news. It is a record of solid progress in managing the machinery of government; but it also tells a story of unmet objectives and missed opportunities.

1.2 That overall assessment requires me to add two immediate qualifications. The first I have made several times before: that the nature of an audit report places an emphasis on the negative. My mandate requires me to bring to the attention of the House of Commons instances where "accounts have not been faithfully and properly maintained" and where "rules and procedures have been *insufficient*" and when "money has been expended *other* than for purposes for which it was appropriated" or "*without* due regard for economy and efficiency" and where "satisfactory procedures have *not* been established" (my emphasis).

1.3 My only mandate for informing Members of Parliament that, for example, a department has initiated excellent management procedures that could usefully be copied by other departments, lies in the phrase of the Auditor General Act that instructs the Auditor General to "call attention to anything that he considers of significance and of a nature that should be brought to the attention of the House of Commons". Such positive comments are made throughout this Report. I believe they give it balance and fairness. But – as again I have remarked before – it takes many more words to describe fully a problem situation than simply to cite a program that is working well. So chapters can seem to be all negative coloration. All I can do here is re-emphasize that much of the machinery of government is in good order; many programs work well. But, by its nature, my annual Report does not give equal weight to this positive side of things.

1.4 My second qualification flows from my first. I have become increasingly troubled that it is taken for granted that the appearance of the annual Report of the Auditor General is primarily an occasion that allows the media and the opposition parties in Parliament to lambaste the government of the day; which, in turn, fuels the scepticism of many Canadians about government generally.

1.5 Governments in our country today account for very nearly half of the total economy. The activity of the federal government touches many aspects of our lives. It is a huge operation, and it has its problems. Nonetheless, it has been the collective choice of Canadians to have government play this very large part in our economy, our society, our systems of welfare, health and education. Eroding the credibility of government helps no one. Nor is anything gained, for example, by a thoughtless undermining of the morale of the public service. And very certainly I do not see these things as the role of the Auditor General.

1.6 We need government. We need the mechanisms of government to work well, to provide Canadians with the services they require and deserve, and to provide those services efficiently, economically and – in the case of health and social programs – compassionately.

1.7 I see the work of my Office and this annual Report to Parliament as contributing to that objective – maintaining and strengthening the processes of government.

History and Background

1.8 An example of the contribution that the Office of the Auditor General has made to stronger and better government processes is provided by the Financial Management and Control Study undertaken by my predecessor, Mr. James J. Macdonell, from 1974 to 1976. One result of the 1962 Report of the Royal Commission on Government Organization (Glassco Commission) had been the decentralization of financial control. Departments became responsible for developing their own financial systems and, in large measure, financial control over the public purse passed to departments. Mr. Macdonell initiated his study in order to assess the adequacy of the systems and controls established in departments.

1.9 That study concluded that financial management and control were grossly inadequate; and, in a phrase that was to become famous, Jim Macdonell stated in his 1976 annual Report that "I am deeply concerned that Parliament – and indeed the Government – has lost, or is close to losing, effective control of the public purse." He went on to recommend a new division of responsibilities within the Treasury Board, with a newly-created Office of the Comptroller General to answer for matters of financial management and control. One responsibility of the Comptroller General would be to provide standards for the design of accounting and financial reporting systems for use with each government department and agency. Responsibility for financial management and control would remain with the departments, but the systems would be in place to permit departmental senior financial officers to roll up their numbers, allowing the Comptroller General oversight of the total financial affairs of the government.

1.10 I need not review in detail the sequence of events that followed the reporting of my predecessor's Financial Management and Control Study. These included the appointment by the government of the day of the Royal Commission on Financial Management and Accountability (Lambert Commission) which in 1979 confirmed the Auditor General's findings and went on to identify a number of deficiencies in the chain of accountability between departments and the centre. An important outcome of our Study was the division of responsibilities in the Treasury Board recommended by the Financial Management and Control Study and the creation of the Office of the Comptroller General. And with the appointment of Canada's first Comptroller General there began to be set in place the financial procedures and the information systems necessary to achieving good management and control throughout the operations of the government.

1.11 Important milestones in this progress included issuing the Comptroller General's standards for internal audit in 1978; introducing the Policy and Expenditure Management System in 1979; launching Improved Management Practice and Control, also in 1979;

establishing guidelines for program evaluation in 1981; and introducing the detailed Departmental Expenditure Plans – Part III of the Estimates – in 1981.

1.12 Over the years, the comprehensive audits conducted by my Office have reported on the implementation of these initiatives in individual departments. As well, we have undertaken government-wide studies of internal audit, program evaluation, and the role of departmental senior financial officers, among others.

A New Study

1.13 But we recognized that the time had come to make a more searching evaluation of all that had happened during the last decade, to try to determine the effects of the new measures put in place largely as a result of this Office's original Financial Management and Control Study and the Lambert Commission's work. So two years ago I authorized a new study to examine and assess the adequacy of the present financial management and control practices across government. The findings of our study dominate this year's annual Report. Chapter 4 reports the major results of our new Financial Management and Control Study, and the chapters that follow provide detailed findings from our examination of individual departments.

1.14 The findings are both encouraging and troubling – encouraging in that major defects have been overcome, particularly in the area of financial control; troubling because – especially in the area of financial management – the full pay-off that might have been anticipated from all the effort that has been put into new procedures does not seem to have been realized. I want to come back to these disappointments, highlight some that I see as being of special significance, and begin to explore what may be deeper causes of the symptoms our study reveals.

1.15 **Financial control.** But to the good news first. Our study finds that there have been significant improvements made in financial controls. The government now has systems and procedures that provide essential financial controls. Departments have corrected the fundamental weaknesses identified in the 1970s. With expenditures by our federal government exceeding $100 billion a year, protecting the public purse demands that the correct amounts be paid out to the intended recipients at the right time. A decade ago the Auditor General could provide no assurance that this was happening. Today, I can do so. The essential framework is in place. With some exceptions, financial controls are working well.

1.16 **Financial management.** Financial management is a different story, although, here again, there are positive things to be said. If financial control can be defined as ensuring the proper recording and protection of government assets and ensuring that Canadians' dollars are spent for the purposes and in the amounts approved by Parliament, then financial management means that the decision makers should be fully aware of the financial implications of their decisions, make sure that public funds are spent with due regard for economy, efficiency and effectiveness, and ensure that information is available so that they can be held fully accountable for the way they have spent the taxpayers' money.

1.17 In brief, good financial management means that resources should produce effective results and provide value for money. That is still not happening as it should. Our study tells of the problems.

1.18 But I can begin on an encouraging note. To quote from Chapter 4 of this Report:

> This is not to say that nothing has been accomplished over the past decade. There are tools in place that, if properly refined and used, could provide necessary support to new management initiatives. Program evaluations may provide one means of determining the effectiveness of government activities. Part III of the Estimates has done much to provide Members of Parliament with more information on departments. Within departments, there is now a greater interest in financial management and control. We have noted in a number of departments the steps taken by senior managers to improve the information on which they make decisions with financial implications. The shortage of resources has, in many cases, made managers aware of the need to use what resources they have more efficiently and effectively. Several of the departments we examined have made considerable progress in the past two years.

1.19 **The problems.** I want to comment on several of the continuing problems identified by our Financial Management and Control Study. In highlighting them, I encourage the careful reader to examine the total study; not only Chapter 4 but the detailed observations contained in the departmental chapters. What I am doing here is simply stressing those issues relating specifically to financial management that I see as being of special importance and interest before I attempt to explore some of the continuing problems that seem to me to underlie the findings of the study.

1.20 Our study reveals that:

- Although there is a massive amount of data available from governmental accounting systems, the data seldom translate into the kind of financial information managers need to manage.
- When decision makers initiate new programs and capital projects, the quality of information varies from department to department and project to project.
- For the most part departmental budgeting is still a process of allocating resources based roughly on what programs contained in previous years.
- Managers seldom have at hand the financial information they need to ensure that their programs are providing value for money.
- Few ongoing measures of effectiveness have been developed. The Operational Plan Framework concept has yet to prove its worth; and it may be flawed. The introduction of program evaluation has slowed.
- For the most part, efficiency measures are either not in place or they are inadequate. Or they are not being used to increase efficiency.

- The cost information needed to make decisions on resource allocation or for cost recovery purposes is often not available.
- Few managers are held to account on the basis of the efficiency or cost effectiveness of their operations.
- Financial accountability from departments to the centre has been weak.
- Part IIIs of the Estimates provide good information to Members of Parliament about the existence of programs; they are not so good at telling MPs how well the programs are working and how well resources have been used.

1.21 These issues are fully discussed in the chapters of this Report relating to our study. But one aspect particularly troubles me, given my background as an accountant. It is the question of information on costs.

1.22 **Inadequate information on costs.** No individual, and certainly no business person, should try to manage an enterprise without some understanding of all the costs involved. In so relatively straightforward a matter as the purchase of a home, a person must consider not only the price being asked, but the cost of financing a mortgage, the amount of property taxes, the likely costs of any immediate or prospective repairs, the annual bills for heat and light, and so on. In a business venture, costs become even more critical. Against anticipated revenues must be set a whole range of expenditures – not only for the start-up period, but estimated over the whole life of the project. Without such cost information, an enterprise in the world of the private sector would almost certainly be doomed.

1.23 What our study reveals, for far too many of the programs and projects of the federal government, is that cost information required for making decisions on the allocation of resources and the management of operations is often not available. And as long as they stay within their overall budget allocations, managers are seldom challenged on the costs of programs.

1.24 For example, our audit of the Department of Transport (Chapter 13) reveals that cost information is incomplete and not always timely. This is all the more significant because – as I am going to point out very shortly in these remarks – the Department is engaged in an important cost reduction program.

1.25 For the nine airports projected to be self supporting within the Airports Revolving Fund, cost information is inadequate to an extent that makes it extremely difficult, in our auditors' view, to set and justify rates and control costs. Because of the lack of timely cost information the Department does not always know whether it is making or losing money on a monthly basis by key result areas where it operates in a quasi-commercial environment. Cost information could help the Department pinpoint avoidable losses. It could also support greater cost recovery and assist managers in controlling costs.

1.26 This kind of information is crucial. Decision makers, including Members of Parliament, need to know not only the immediate but the long-term cost of projects being initiated. Operational managers need to know the true cost of their operations. I wonder, for example, how many managers know the real costs involved in adding, say, a fairly senior employee to their payroll. It is not only a matter of salary and such obvious things as pension contributions, or even one-time costs like relocation expenses. There are long-term considerations such as the provision of office space and support services. A manager seeking to be cost conscious should have this kind of information readily available.

1.27 On a larger scale, some realistic estimate of the full life cycle costs of any initiative is crucial to identifying opportunities for improving efficiency and reducing costs. These estimates must include such things as the cost of maintaining inventories, the upkeep cost of buildings, the cost of financing uncollected receivables, the cost of replacements and the cost of not taking action when replacements are called for. These are commonsense examples of the kind of cost information that any enterprise needs, whether in the public or the private sector.

1.28 Now, in emphasizing these needs, I wish to be clear that I am not advocating the imposition of elaborate government-wide cost information systems. Today's flexible information technology permits the decision maker to determine the major initial and ongoing costs of an initiative and can also provide operational managers with data on the costs they can control.

1.29 It is such straightforward mechanisms that I would like to see in place. I will be asking our auditors to identify instances where departments have failed to set up such mechanisms; and I will also report positively on the successful implementation of good cost information systems.

1.30 Above all else what is needed is an environment where managers are rewarded for reducing costs while maintaining, and indeed strengthening, services. That environment does not now exist. Until it does, I have little hope that good cost information systems can be developed.

1.31 To return to that wider catalogue of financial management problems identified by our study, one has to observe that, granted the time, effort, organization and money that have been directed toward improving financial management in government through the years following this Office's initial Financial Management and Control Study and the Report of the Lambert Commission, our current observations make rather dismal reading.

1.32 Why do problems persist? If the continuing problems in achieving good financial management in government are seen as symptoms of a deeper malady, what is the nature of the underlying disease? I believe that this year's Report suggests answers. And I want to come toward those answers from two different directions.

Probing for Answers

1.33 **The case of financial management information systems and the use of microcomputers**. This year's Report has much to say about the use of electronic information technology in departments. Governments are largely in the business of information. Electronic information systems should therefore offer enormous potential for reducing costs and making government operations more efficient. And indeed the federal government has a huge installed base of computer systems and continues to invest more than $1 billion each year in data processing. In the chapters on our Financial Management and Control Study – particularly in the chapter on the Department of Supply and Services (Chapter 11) – this Report examines the use of electronic data processing in financial management systems. Also included in the Special Audits chapter (Chapter 15) are the results of our review of the introduction of microcomputers in government.

1.34 In the case of large systems, what we find is discouraging. There is a pattern of project failures, cost overruns, poor operating performance, duplication of effort and sheer waste. It is a chronicle of millions of dollars poorly spent. Harder to quantify, yet immeasurably more costly are the lost opportunities: the staff years that could have been put to better use than in maintaining manual ledger cards; the accurate and timely financial information that could have been supplied when it was needed; the new and innovative ways in which financial services could have been delivered if the millions spent on electronic systems had been more productively managed.

1.35 Why has this happened? Building computerized financial management systems should be well within the ability of departments. There is no shortage of funds; but what our chapters report is a pervasive disregard for principles of good management. There is no clear accountability for delivering projects on time and within budget. Full costs are not tracked or disclosed; as long as funds are available in departmental budgets, money continues to be spent on projects far beyond the original estimates. Some projects take five to eight years to complete. During that time, user needs, legislation, project managers, senior managers and the underlying technology all change dramatically. The result is a confused melange of promises, estimates and changing decisions.

1.36 It is not surprising therefore that our audits find that costs have frequently gone out of control and opportunities to use technology to advantage have been missed. Many of the systems built at such great effort and expense have failed to meet departmental needs and have either been abandoned or are being replaced.

1.37 It should also be pointed out that this overall story of failure cannot be blamed on departments having to operate in a political environment. There is no evidence that there have been external factors contributing to the extensive problems encountered in developing these systems. The whole story is bad news for the taxpayers of Canada.

1.38 However, a different account emerges from our special audit of the introduction of microcomputers to government. Our study tells of the imaginative use of microcomputers in a range of departments. By March 1986 the federal government had 12,000 microcomputers, making up one-fourth of its computer workstations.

1.39 The use of microcomputers in government is not without problems. Our review reports that microcomputers are often purchased without relating their acquisition to an overall plan for using information technology. When local area financial systems are automated on microcomputers, this is too often done in isolation from centralized departmental financial systems. Insufficient attention is given at the time of purchase to the long-term costs of training and the further costs involved in developing applications. There are also concerns about the security of information stored in microcomputers.

1.40 But the overall message is positive. The microcomputer is already proving its worth in contributing to the economy, efficiency and effectiveness of government. Microcomputers are being successfully used in a wide range of applications that are allowing individuals and teams to do old things quicker and better and to do entirely new things.

1.41 Key, in my view, to these encouraging developments is the recognition that individual public servants have at their own command in the microcomputer a hands-on tool that not only permits and encourages innovation but also fosters a person's pride in doing a better job, faster and at a reduced cost.

1.42 It is important not to draw the wrong conclusions from our study. First, microcomputers are no overall substitute for the large mainframe systems that the massive information needs of government demand. Second, one must not fall into the trap of believing that microcomputers will automatically bring about improvements in economy, efficiency and effectiveness. That only takes place when they are used in a planned organizational context designed to take full advantage of the benefits they provide.

1.43 But what interests and intrigues me is that whereas our audit observations about the development of large computerized financial management systems are very largely negative, our findings on the use in government of microcomputers are generally positive.

1.44 Part of the answer to the dilemma of why this should be lies in the fact that 'small is beautiful'. The development of a microcomputer system is relatively simple with a high probability of success because it usually involves only one or two people, who are themselves the ultimate users. But from what we have seen, development in the government today of large department-wide financial systems has too often involved an incredibly complex process and a very large number of people who have been tracking a shifting target over an extended period of time.

1.45 There is, in my view, a lesson to be learned from the success of these smaller systems that can be applied to developing the very largest systems. If there is a clear definition of goals, together with management's commitment and acceptance of accountability; and if, in addition, these large projects can be broken down into manageable pieces, each being tackled by small dedicated teams responsible for producing results on time, then taxpayers' money will not be at risk.

1.46 For it has been the dedicated, enthusiastic and innovative individual and team that is making best use of microcomputer technology – and there is evidence that this is happening throughout government. This fact tends to give the lie to that unhappy and largely slanderous image of the public servant as an unimaginative individual simply filling in time with never a creative thought. And, at a deeper level, it tells of a too often stifled potential within the public service, of an enthusiasm and ability to innovate that seems to have been frustrated for far too many years.

1.47 **The case of tighter resources, increased ministerial authority and accountability, and cost reduction at Transport Canada**. In virtually all departments at this time there is a reduction in overall resources. This reduction goes hand in hand with new government initiatives to give more authority over those resources to ministers and departments. The stated objective of this increased flexibility is to encourage more productive management within departments. I commented in my Report last year that I would be watching the implementation of this new philosophy with great interest. I see it as an imaginative approach toward spending taxpayers' money with increased prudence. This year's Financial Management and Control Study looks at the introduction of this Increased Ministerial Authority and Accountability. Although concurring with the principles on which it is based, our study expresses some misgivings about the processes on which it depends. However, these are early days and I remain hopeful.

1.48 In addition, there are some very interesting observations in the chapter of this Report on financial management and control in the Department of Transport (Chapter 13). The observations relate to a major cost reduction plan in the Department covering the years from 1985 to 1991.

1.49 Quite apart from the actual reductions in expenditure that are being achieved, the plan is proving important at an attitudinal level. My staff who have been conducting the audit tell me that not only have there been tangible improvements in the area of financial management, especially in the last two years, but that managers are more cost conscious. The attitude of operational managers and corporate decision makers toward better financial management is positive. They believe that the deficit reduction targets have imposed a bottom-line for savings at Transport Canada. Except for the areas of asset management and corporate financial information systems, most of the basic elements or systems required for good financial management are either present or are slated for future implementation. A change in attitude is discernible everywhere, amounting to a changed culture throughout the Department. Transport Canada's own people speak unselfconsciously of the contrast between the pre-deficit reduction period and the post-deficit reduction era.

1.50 Now one swallow does not a summer make – there is a caveat. Cost reduction must not be an end in itself. Worthwhile programs and services are the ultimate objective. And if – and this is a point firmly made in our Financial Management and Control Study – the appropriate financial information about programs is not available, mere cost cutting will be a crude instrument at best, and at worst can do more harm than good.

1.51 That having been said, however, our audit team at Transport Canada reports that in the case of capital projects for example, the quality and effectiveness of financial advice and analysis have markedly improved in the last two years, in part because of the competition for scarce resources caused by the deficit reduction exercise.

1.52 A project that reflects an increased awareness of cost recovery was the establishment of an improved United States pre-clearance facility at Lester B. Pearson International Airport in Toronto. The Department ensured that the major beneficiaries, the airlines, signed commitments before construction began on this $5.2 million project, scheduled for completion in October 1987.

1.53 The proposed construction of a third terminal at the Pearson International Airport again illustrates the type of approach that the Department is now pursuing. It evaluated the options available to relieve capacity problems in the two existing terminals and selected the construction of a third terminal as the most cost-effective solution. The Department requested proposals for the funding and operation of a third terminal that would meet its requirements. The proposals have been evaluated and the Department has selected a private sector solution.

1.54 These examples provide solid evidence that when departmental autonomy is paired with a squeeze on money, the combination can bring about a sequence of initiatives that translates into good decisions.

1.55 I link these observations back to the positive findings from our microcomputer study. Given clear goals, the tools to do the job, and the autonomy to act, public servants can and do take pride in ensuring that the programs and services of government are delivered cost effectively.

1.56 And the motive for creating that environment and for acquiring those tools must come through a value system that fosters pride in how much is saved rather than in how much is spent, and through eliminating those blocks that public servants perceive as thwarting them in doing the best job possible.

1.57 I recognize that in saying this I am repeating a point that I have made time and again since becoming Auditor General – that the introduction of improved systems and processes for better financial management will never succeed unless they are accompanied by a conviction in people's minds that value for money is vital. And my concerns in this area are heightened by the findings of our Financial Management and Control Study. Our chapters this year reveal that in many instances the systems and processes for good financial management could by now be in place, but that there is no great enthusiasm in departments for taking advantage of such systems. It is too often as though departmental managers are saying: "If the central agencies want us to provide financial and program information and measurements of our efficiency and effectiveness, we will of course provide them. But we don't see that information as being at all relevant to the day-to-day job we are being asked to do. So providing it is a tiresome task that we will perform in a desultory manner."

Three Responses

1.58 That kind of sentiment demands a reasoned response. And I believe that there are answers and solutions. Here I suggest three. The first two are at hand. The third is more long term and further reaching. What they have in common is that they are answers and solutions that essentially involve attitudes and values and the harnessing of the skills, inventiveness and enthusiasm of people.

1.59 **First response: back to basics.** It is not only in government that externally imposed systems are seen as being irrelevant to the operating manager's needs. Today's accounting literature provides numerous examples from the private sector of line managers being frustrated by what they see as the irrelevant requirements of external reporting systems. What may well be needed to begin with is a return to basics, to ask what makes sense and what is important for running a department and its programs. What information is needed for local planning and control? And instead of seeking to extract such information from systems designed primarily to satisfy external reporting requirements, design and implement simple and local internal systems consistent with the program needs and strategy of the department. Always ensuring, of course, that the systems are compatible with the need for rolling up the information for centralized control and accountability purposes.

1.60 A prime focus must be value for money. This year's chapters reveal that there are considerable opportunities for improving productivity in departments. That is to say, with the same resources departments could provide more and better services. Our audits also reveal that senior managers are often unaware of such opportunities, even though departments collect massive amounts of data and each year print many millions of pages of information about their own operations. And in cases where management does know of opportunities to improve productivity, such opportunities are often neglected.

1.61 The question arises why this should be so. It is an issue well worth emphasizing because, on a positive note again, there are instances where departments have achieved significant performance improvements for specific programs. I plan to explore these and related productivity questions during the coming year and report on them in my 1988 annual Report.

1.62 Attempts to define the effectiveness of programs have become so complicated as to slow the evaluation process. And one hears the argument that measuring the effectiveness of government programs whose results are often intangible is next to impossible. However, governments are not the only organizations that have moved into a post-industrial age, where products cannot be as conveniently measured as those leaving a factory. There is today an increasing literature concerned with developing means of calculating the effectiveness of the kind of programs governments are involved in, and there is increasing experience in using such tools.

1.63 The key as I see it is to concentrate on what is simple, to develop systems at the departmental level that will provide not only information about the outputs of programs – how many pamphlets were produced, how many individuals were served – but, much more importantly, about their outcomes. Is the program achieving its intended effect?

1.64 What is required is the change of orientation promised in the launching of Increased Ministerial Authority and Accountability. The need is for a change of philosophy – from a top-down, externally imposed system toward the recognition that good overall financial management in government will come about only when it is seen as the sum of good financial management in every constituent part.

1.65 Canada's government does not need managers who can serve systems; it needs systems that can serve managers – managers who are seen as responsible and competent decision makers.

1.66 **Second response: accountability runs both ways.** Our Financial Management and Control Study concludes with a section on the role of the agencies of the Treasury Board in relation to improved financial management and control. It raises a number of questions. The final three speak directly to the issues I am discussing here: What is the dividing line between "letting the managers manage" and ensuring that departments are being managed so as to meet the objectives set by government? What mechanisms exist at the centre to detect problems in departments? What can and should be done when problems are identified?

1.67 The reminder implicit in these questions is that accountability must be a two-way process. Our study rightly emphasizes that departmental managers must account for the responsibilities they are given. They must at all times be answerable for their actions and their stewardship.

1.68 But this is only one-half of the concept of accountability. The other side of the coin is that a corresponding obligation rests with the individual or group that requires the manager to be accountable. The individual's superior is accountable to the individual: to question, to listen, to understand, to encourage, to be supportive; above all else, to identify with the problems the person faces in doing her or his job and to ensure that accountability mechanisms help rather than hinder.

1.69 As our study reiterates, it is vital for good management that managers be held accountable. But it is equally important that they be held to account in ways that are meaningful and constructive. I sense that, despite the best of intentions, there has been a breakdown of realistic communication between individual departments and the agencies of the Treasury Board. As long ago as 1962 the Glassco Commission asserted that "where there is delegation, there must also be an assessment of the manner in which authority is exercised and responsibility discharged, and performance must be measured against the goals pursued."

1.70 If managers are both to manage and be accountable; if concepts like Increased Ministerial Authority and Accountability are to work; if restraint and cost-consciousness are to move from being mere buzz words to become realities – then improved communication, mutual trust and shared accountability between managers in departments and those in the central agencies must also become realities.

1.71 **Third response: a renewed value system.** It is significant that it is not only our Financial Management and Control Study in this year's Report that addresses the question of the values that motivate and drive senior managers; the chapter on our audit of the Management Category in government (Chapter 17) makes clear that the original aim in initiating the Management Category was to create a strong cohesive management team motivated and dedicated to the pursuit of government objectives. However, our audit reveals the sad reality that many of the hopes for this senior management cadre have been frittered away by an overall absence of focus, leadership and direction for Management Category policies. Indeed, the whole study of the category's first seven years is largely one of expectations raised but not fulfilled. Nonetheless, the creation of a clearly identified management group continues to be a valid objective.

1.72 This supports my own conviction that one major ingredient missing in achieving greatly improved performance in the public service is a shared commitment to that aim by a strong, cohesive management team dispersed throughout all the departments and agencies of government.

1.73 I have initiated a study on managerial values as they affect value-for-money management in the public service. It is to be a modest study in terms of time and money. In one aspect it can be seen as a follow-up – especially in the light of our Financial Management and Control Study – to the chapter in my 1983 annual Report entitled "Constraints to Productive Management in the Public Service". One message of that chapter was that:

> The effect of constraints on productive management in the public service is that achievement of value for money is generally accorded a low priority and that managers are frustrated and lack motivation when it comes to making productivity improvements.

1.74 Our new study is essentially a study of management values. Work has begun, and I have been drawing on some of our early findings in writing some of the foregoing paragraphs. The study has already involved a number of interviews with senior managers in the public service. The preliminary messages we are getting are striking and perceptive; and because they relate closely with this year's findings about financial management I am touching on them here.

1.75 One tentative explanation for the generally low priority placed on productive management is gradually emerging. The value system of senior public servants seems to place the achievement of greater productivity below the attainment of improved service delivery. But this state of affairs may simply reflect values that have been long held in the public sector. It would be futile to berate public service managers for acting according to the values held by those to whom they are accountable and who have control over their careers.

1.76 The democratic nature of government activities, including the principles of fairness, equity and virtually unlimited accountability, appears to have focused extraordinary attention on due process, as compared to the actual attainment of specified products or desired outcomes. This focus may have been accentuated in the managers' mind by central agencies' emphasis on systems designed to measure process rather than product.

1.77 The introduction of productivity improvement initiatives and of increased managerial authority may have been incomplete in the sense that these efforts omitted to take into account the contrasting values of individual managers, of the department, and of government as a whole. The resulting value conflicts may have hampered the achievement of productivity goals.

1.78 Our study is beginning to show that values play a far more important role in the behaviour of managers than has so far been acknowledged. As indicated above, public servants in according a lower importance to value for money management may be reflecting what seem to them the priorities of our system of government. Until there is a consensus as to which will be the governing values, attempts to improve productive management may be severely inhibited.

1.79 A separate but related issue is emerging from this year's study on financial management and control. It is the almost frenetic shortness of tenure of both ministers and deputy ministers in departments (see Chapter 4, Exhibit 4.8). I know that comparisons between the private and public sectors can sometimes be misleading. But one has to wonder how long an ordinary corporation would survive if its president and its chairman were each replaced every two years. Playing executive musical chairs does not contribute to secure morale, good accountability or high performance.

1.80 Yet it is instructive to keep all those things in perspective. Visitors from virtually any country in the world would affirm that Canada possesses a talented, dedicated, independent and hard working public service. And they would be right. But a closer examination would also surely reveal that Canada's public servants have been frustrated in fulfilling their potential and that there has been an erosion of morale and of purpose.

1.81 Our Financial Management and Control Study addresses problems that can be seen, in some instances, to relate to this loss of morale. Our audit of the Management Category explores some of the particulars of these issues from a rather different direction, telling a story of missed opportunities. Both have positive things to say, and include recommendations for overcoming the problems. I confidently expect that our study on management values will shed even greater light on these matters. I hope that our efforts can serve as a useful and constructive contribution to helping build a renewed sense of pride and purpose throughout our public service.

1.82 It is people who are the most vital resource of all.

Financial Management and the Federal Deficit

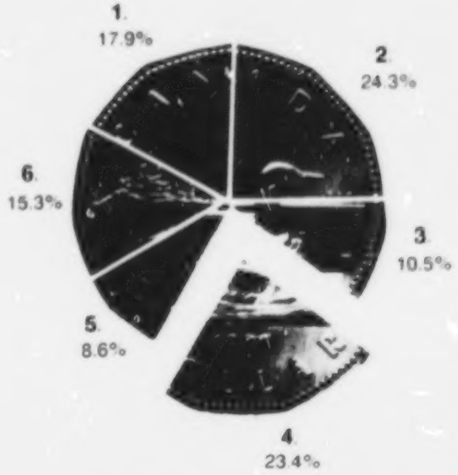
1.83 There is another and quite different issue that links back to our Financial Management and Control Study in three distinct ways. It is the issue of the federal deficit.

Exhibit 1.1

EXPENDITURES OF THE FEDERAL GOVERNMENT
(estimated, in billions of dollars)

Fiscal Year Ended 31 March 1987

1.	Transfers to other levels of government	$ 20.7
2.	Transfers to persons	28.0
3.	Other expenditure	12.1
4.	**Public Debt Charges**	**27.0**
5.	Defence	9.9
6.	Operating and Capital Expenditure	17.7
	Total	$ 115.4



Source: Public Accounts of Canada and Department of Finance

Three Links to Financial Management and Control

1.84 The first link is a matter of sheer numbers, numbers that must be of interest to every Member of Parliament. Exhibit 1.1 provides an overview of the expenditures of the federal government. Our study looked primarily at the quality of financial management of the 15 per cent of taxpayers' money that goes to operational and capital expenditures, and also examined management and control of transfer payments and subsidies to ensure that the right recipients are getting the right amounts. But Members of Parliament - and all Canadians - will swiftly recognize that some really big dollars seem to lie largely outside the boundaries of our study - specifically the 23 per cent of government expenditures that services public debt. And they may well ask if improved practices in financial management and control can have any impact on that staggering sum.

1.85 They can. Let us suppose that over the 10 years since our last review of the government's financial management and control systems, improvements in such systems had allowed the government to save $100 million a year. If we assume that such savings resulted in reduced borrowing, it would mean that outstanding government debt in the fiscal year ending 31 March 1987 was about $1.8 billion lower than it would otherwise have been ($1 billion in reduced program costs; $800 million in accumulated interest savings). It would also mean that the deficit in that year was lower by $270 million ($100 million of direct savings and an additional $170 million resulting from savings in interest). Continuing gains would be realized in the future.

1.86 Thus, even relatively modest improvements in government operations can have a significant and lasting impact on the federal deficit.

1.87 The second link to our study concerns the availability of timely and understandable information. The major thrust of our study was to determine whether financial management and control in government have improved since our previous findings were published a decade ago. That question can be addressed in detail only every few years, but I am well aware that Members of Parliament and others also need routinely available information to monitor, analyse and assess overall government performance.

1.88 In previous reports, I have noted that Members of Parliament have expressed a strong desire for summary-level information that will allow them to see the big picture, including trends in key indicators of government financial performance.

1.89 Over the past decade, the federal deficit has come to represent one of the most visible symbols of government financial performance. But it seems to me that Members of Parliament receive very little information from which to discern the reasons for our federal deficits and their down-stream implications.

1.90 I am required to audit the deficit as reported in the government's summary financial statements each year, and have commented critically on the accounting policies used in preparing the statements. However, my own understanding of the fundamental causes that give rise to the deficit, and their implications, has been limited. I therefore asked some economists to help me study the matter.

1.91 Our work has convinced me that the deficit, as it is usually presented, masks a wide range of information about the financial condition and performance of the federal government. Only if the deficit is analysed and presented in a number of different ways can MPs get a real handle on its implications for government operations and the state of the nation's economy.

1.92 We found that this kind of useful information about the deficit could easily be provided by the Department of Finance to Members of Parliament on a regular basis, and that this same information could also help us concentrate our audit resources on areas of greatest significance to MPs.

1.93 The third link back to our Financial Management and Control Study reflects my thinking about management values. Today's auditors cannot confine themselves to looking at symptoms; they must probe for causes. It is not enough to ensure that the numbers are correct; we must ask the meaning of those numbers. As the inquiry into the collapse of the Canadian Commercial Bank and the Northland Bank makes clear, auditors have a responsibility to step back and exercise their professional judgement in the light of their fullest possible understanding of the total environment in which financial and management decisions are being made.

1.94 As Auditor General, my view is that the extent and nature of Canada's deficit and debt must be seen as an inescapable part of the environment for all those who make decisions about government expenditures. So we all have a responsibility to understand more about the deficit and its meaning.

Analysing the Deficit

1.95 Deficits occur for many reasons. To be sure, some of the decisions that have led to annual deficits reflect intentional fiscal policy decisions designed to influence the course of the nation's economy. But in government as in business, deficits can also grow unintentionally because of factors such as inadequate systems of financial management and control.

1.96 **Progress on the federal deficit.** During the fiscal year from 1 April 1984 to 31 March 1985, the federal deficit shown in the Public Accounts was $38.3 billion, the largest deficit in Canada's history, both in absolute amount and relative to the size of the economy (8.6 per cent of Gross Domestic Product). Since that time, the deficit as reported has become smaller: $34.4 billion in fiscal 1986 and an estimated $30.1 billion in fiscal 1987 (see Exhibit 1.2). Recent forecasts by the Department of Finance suggest further reductions in fiscal 1988 to $29.3 billion.

1.97 But as long as outlays exceed income, the federal government will continue to increase its borrowing, thus adding to the outstanding debt. Servicing this outstanding debt will continue to be a major expenditure. These are concerns that I have heard Members of Parliament and many other Canadians express. But what indicators are available so that people can understand the causes of these trends better?

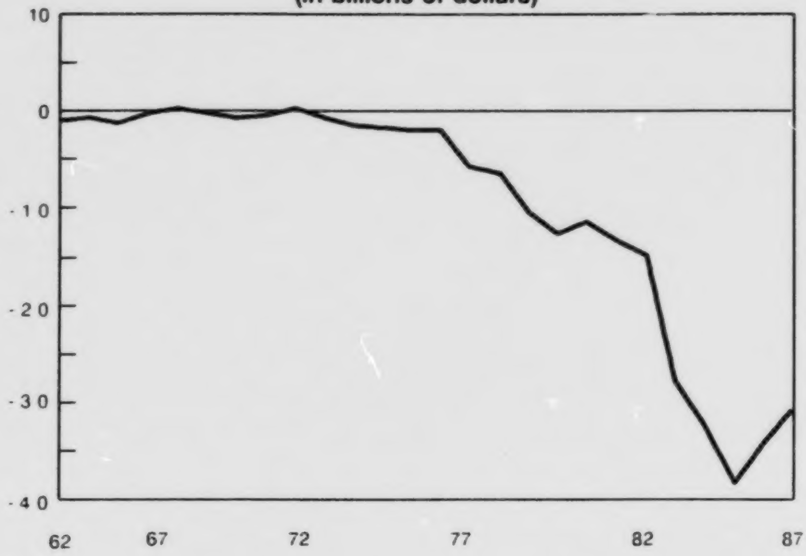
1.98 Economists have developed a whole "toolkit" of measurements and indicators that, in effect, take the deficit apart in order to view its implications more clearly. Like most specialists, including auditors, economists describe their tools in jargon that to most of us would sound like another language. (For those who are interested, some of the economic concepts are presented and explained in the Annex to this Chapter). But I have discovered that you do not have to be an economist to understand these useful indicators or to discuss them in plain language And I believe that Members of Parliament and Canadians in general will be interested in the messages they convey.

1.99 **Components of the deficit.** I realize that if the deficit were caused by a deep recession, it could be temporary in nature. Certain expenditures built right into the federal budget, such as Unemployment Insurance, are designed to cushion a recession. At the same time, personal and corporate taxes would fall or grow less rapidly, leading to a larger deficit. With economic recovery, such a deficit would be expected to dwindle as these expenditures decline and tax revenues rebound.

1.100 But the deficit as it is normally presented does not convey enough information to indicate whether it also reflects a more serious problem whereby all or part of the deficit would persist even with the economy running well.

Exhibit 1.2

FEDERAL SURPLUSES AND DEFICITS
Fiscal Years 1962 to 1987
(in billions of dollars)



Sources: Public Accounts of Canada and Department of Finance

1.101 I find it helpful to think of the deficit having three components - one attributable to the Canadian economy performing poorly; a second representing the difference between program expenditures and government revenues adjusted to what they would be if the economy were performing well; and a third representing the net financing costs of current and past deficits.

1.102 A breakdown of the deficit into these three components is prepared by the Department of Finance, but the results are reported only from time to time (and even then in language remote from the average reader). Would it not be more informative for the Department to present and interpret this information on a regular basis and in non-technical terms in order to enhance the level of public debate and understanding?

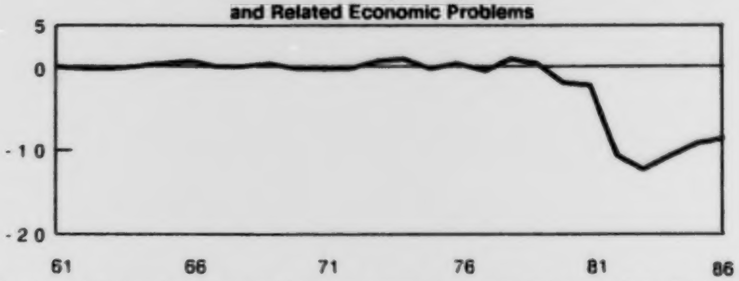
1.103 Estimates prepared by the Department of Finance indicate that government expenditures would have out-stripped revenues by some $16.2 billion last year even if our economy had been running more or less at its full potential. In other words, better economic conditions alone will not be sufficient to see an end to Canada's federal deficit (see Exhibit 1.3).

1.104 If this sort of information is not provided regularly, Members of Parliament may not be in any position to know about - or do anything about - the government's financial situation.

Exhibit 1.3

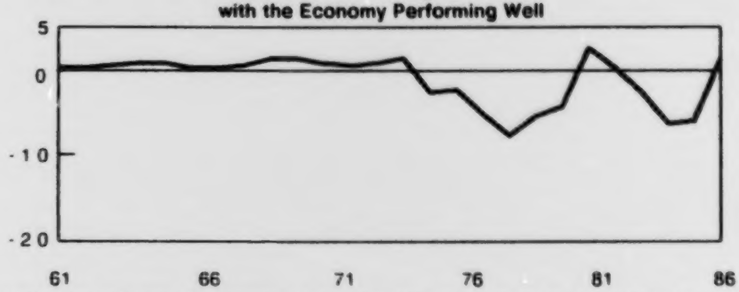
COMPONENTS OF THE FEDERAL DEFICIT
(in billions of dollars)

Deficits Caused by Unemployment and Related Economic Problems



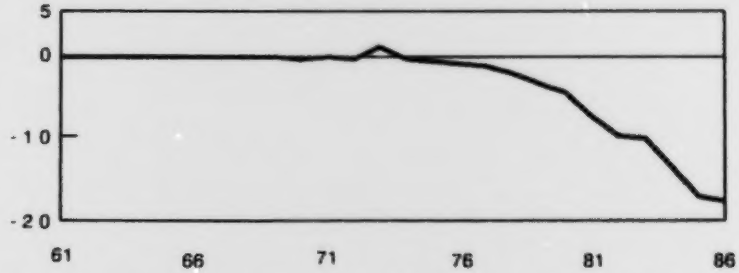
This chart indicates that unemployment and other economic conditions that reduce federal tax revenues and trigger higher unemployment benefits contributed $8.6 billion to the federal deficit in calendar 1986. Improvements since 1983 mirror improvements in the state of our economy during those years.

Revenues Minus Program Costs with the Economy Performing Well



This chart indicates that had the economy been operating at or near its full potential in calendar 1986, government revenues would have exceeded the cost of government programs by $1.4 billion in that year. The chart indicates substantial improvement in this indicator in recent years.

Deficits Caused by Interest Costs



The federal government must borrow money to finance deficits. This chart shows the increasing burden of yearly federal net interest payments needed to cover the cost of past and present borrowing. Net interest payments contributed $17.6 billion to the federal deficit in calendar 1986 (gross interest payments, $26.4 billion; gross interest receipts, $8.8 billion).

Source: Statistics Canada and Department of Finance.

Note: Data prepared by Statistics Canada and the Department of Finance is for the calendar year rather than the 31 March fiscal year, and is estimated on a somewhat different basis (National Accounts) than the data shown in the Public Accounts. But both sets of data show similar trends over time.

1.105 **Why would deficits persist?** One possibility is that tax revenues would be insufficient to cover the costs of government programs. However, had the economy been performing at or near full potential last year, the federal government's total expenditures on programs and transfer payments – that is to say, all expenditures excluding interest payments to service the national debt – would have actually been less than federal revenues by $1.4 billion. This represents substantial government restraint since, by the same measure, the government was about $6 billion in the red in the preceding two years.

1.106 What else might explain persistent federal deficits? The answer lies in the nature of deficit spending. Deficit spending in any one year will not only increase the government's borrowing requirement in that year but in subsequent years, through increased interest costs. With revenues being sufficient to pay for programs, the estimated $16.2 billion persistent deficit last year can be attributed to the cost of interest incurred to finance the government's debt, debt that has been accumulated through years of deficit spending. Our entire deficit would result from the need to borrow in order to pay off interest costs on previously incurred debt.

1.107 It is critical, therefore, that the cost of servicing the debt be managed with due regard for economy and efficiency. The debt management process is complex. Decisions are made daily on the type of debt to be issued, its maturity, currency of issue, and timing. Strategic choices must be made regarding the term structure of debt, the relative weight of Canada Savings Bonds and their rates, and the use of guarantees versus debt for financing Crown corporations or, indeed, assisting private enterprises.

Federal Debt

1.108 As recently as 31 March 1975, the federal government's net debt was $25.72 billion or a post-war low of 16.9 per cent of Gross Domestic Product (GDP). GDP is simply a convenient measure of the total output of the economy. The share of net debt to GDP had been declining since the aftermath of World War II. Since 1975, the trend has been dramatically reversed. The ratio of net debt to the nation's Gross Domestic Product has increased in every year, reaching 44.9 per cent at the end of fiscal 1985; 49 per cent in 1986; and an estimated 52.4 per cent as of 31 March 1987 (see Exhibit 1.4).

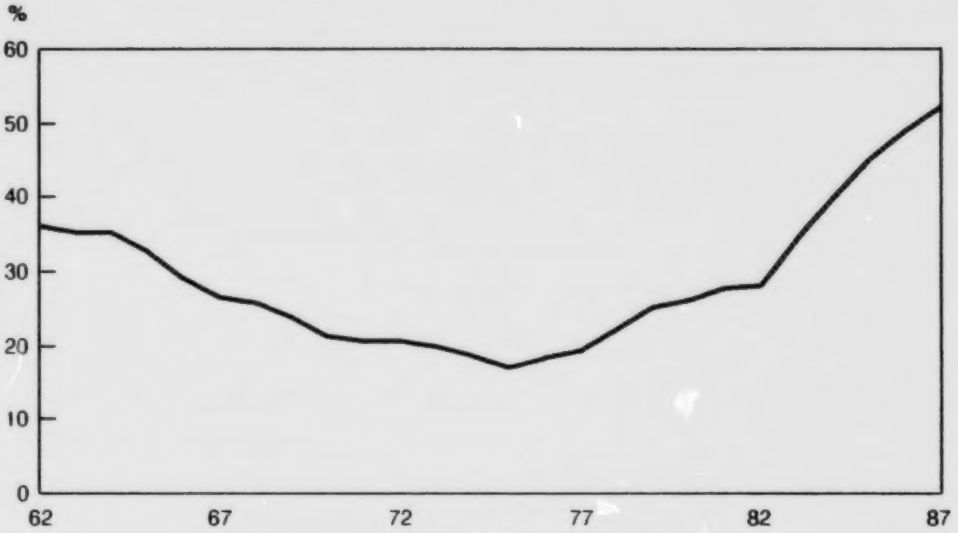
1.109 I recognize that, like a household or business whose income is increasing, a growing economy can support some additional debt. Relative to the size of our economy, however, federal government debt is at its highest level since shortly after World War II.

1.110 Economists tell me that as long as interest rates continue to exceed the rate at which the economy is growing, this ratio of debt to GDP will continue to rise. Even with stable interest rates, interest costs on the expanding federal debt will rise more than revenues linked to the growth of the economy.

1.111 In such circumstances, the growing ratio of debt to GDP can be brought under control only by a government decision to achieve a large surplus of tax revenues over program

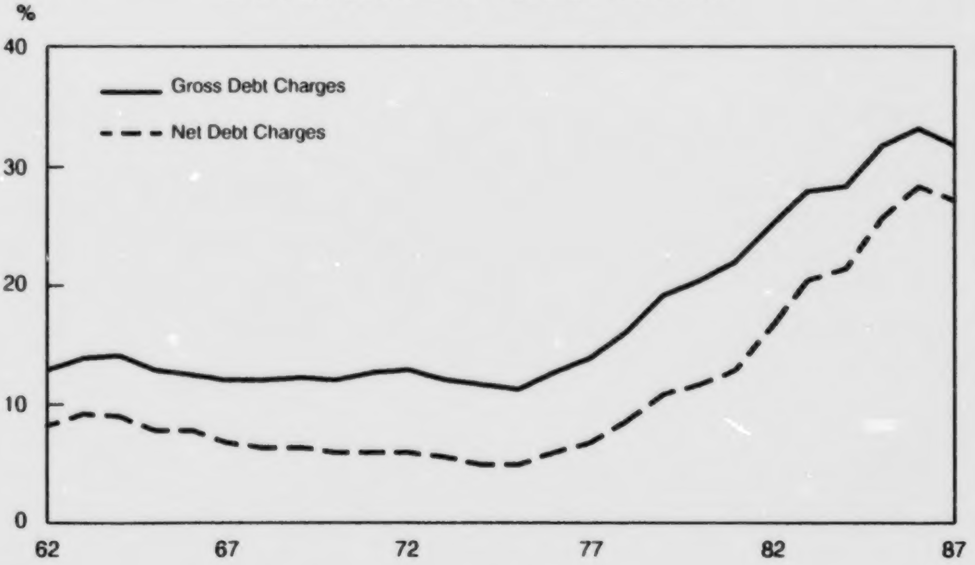
Exhibit 1.4

FEDERAL GOVERNMENT NET DEBT AS A PERCENTAGE OF GDP



Note: Net debt represents liabilities less financial assets
Sources: Public Accounts of Canada and Department of Finance.

DEBT SERVICE AS A PERCENTAGE OF FEDERAL REVENUE



Sources: Public Accounts of Canada and Department of Finance.

costs. In my view, Members of Parliament need to have information on a regular basis about the size of the surpluses required in each of the coming years to achieve such stability, together with information about associated potential economic consequences.

1.112 Whether to run surpluses of this kind is a matter of government policy. It is beyond the purview of my Office. However, any move toward such a surplus that I can help bring about by encouraging improved systems of financial management and control will help stabilize the federal government's debt situation. I hope that the recommendations in this Report can contribute to this process.

1.113 Without such stabilization, the point could be reached where the cost of servicing the government's debt would erode the ability to finance basic programs. From 1961 to 1975, gross interest payments were about one-tenth of gross federal revenues. By 1987, interest costs consumed almost one-third of federal revenues. What was a dime on every dollar has escalated to thirty-three cents. Recent government restraint should enhance the government's ability to continue to provide the services that Canadians need.

1.114 The availability of timely and understandable information and analysis concerning the deficit and management of the public debt are questions of special interest to me. In reviewing the federal deficit situation, I became aware that current and regularly published indicators of the key components of the federal deficit were not readily available. All of us would be better served if this information were published and interpreted on a regular basis.

1.115 **A study of debt management.** Public debt charges represent almost one-fourth of government expenditures. This is a significant component of government activity. I have therefore asked my Office to review the debt management process to ensure that it is being carried out with due regard to economy and efficiency. The results will be published in my 1988 Report.

Other Significant Issues

1.116 While our new Financial Management and Control Study occupies much of this annual Report, there are issues of major significance included in chapters that are not part of the study.

Department of National Defence

1.117 Our audits in the Department of National Defence continue our ongoing examination of this large and important entity that accounts for close to 10 per cent of federal government expenditures. This year we looked at how the Department has carried out some very large projects intended to upgrade or replace deteriorating military hardware (Chapter 9). We also audited Materiel Support (Chapter 10) involving the provision of materiel that our fighting forces need to accomplish their assigned missions. We looked at the total logistics pipeline through which materiel must flow from the original suppliers to those who are doing the fighting, wherever they may be. Both chapters have very interesting matters in them. But I draw special attention here to what I regard as the underlying message about materiel support.

1.118 The clear implication of our observations is that, for a variety of reasons, some within the control of the Department and some beyond its control, the logistic infrastructure is not suitably developed to support our defence forces if Canada were to become involved in sustained conflict.

1.119 As I remarked in the previous section on the federal deficit, one of the advantages of the comprehensive auditing techniques we now employ is that they allow us not only to look at what is taking place but why it is taking place. And in those terms, the origins of the problems the Department of National Defence now faces are reasonably clear. One contributing factor is that the full impact of decisions taken during unification are still being felt. A second was the deliberate decision of the government of the day, in the years following unification, to restrict the budget for national defence in favour of other priorities.

1.120 It was Marshal Foch who said that the military mind always imagines that the next war will be on the same lines as the last - and that it never is. However, ironically, the present dilemma for Canada's military is that, following the advent of the nuclear era, there was a belief that any next war would be quite unlike previous ones; that it would involve a massive and swift nuclear exchange with neither the need nor the opportunity for conventional forces to be supported in the field for any length of time.

1.121 This idea was modified in the late 1960s with the adoption by the North Atlantic Treaty Organization of the strategy of flexible response. And the importance of being able to supply troops over an indefinite period in potentially far flung arenas of conventional warfare is now regarded as strategically vital. The government's June 1987 White Paper, "Challenge and Commitment, A Defence Policy for Canada", states:

> The most effective counter to the conventional threat is to convince any potential aggressor that the chances of an attack quickly achieving its objectives are slight and that, if he were to persist in his aggression, he would run the risk of a nuclear response. This strategy requires adequate and sustainable conventional forces trained, equipped and positioned according to the threat. It may not be necessary to match the other side weapon for weapon, but the more effective the conventional forces, the less is the reliance which has to be placed on nuclear weapons. If early resort to these weapons is to be avoided, the conventional forces in place must be able to fight over an extended period.

1.122 What our audit of Materiel Support reveals is that - because support systems have not sufficiently focused on the capability to support our forces in sustained combat - there are significant deficiencies in the materiel support systems and infrastructure.

1.123 That recent White Paper concludes with a commitment to increase the effectiveness of the Canadian Forces. It speaks of upgrading aged equipment and of "providing a more credible and sustainable contribution to collective security."

1.124 Logistic support is critical to successful combat operations. Our audit draws attention to weaknesses in this area, and also to the Department's important current initiatives in addressing these concerns.

Tax Expenditures Revisited

1.125 In my previous three annual Reports, I addressed a number of issues that flow from the use of tax expenditures to implement policies and programs. Last year's Report discussed these issues in detail and depth. One of my continuing concerns has been that when the Income Tax Act is used to attain economic and social objectives beyond those of raising revenues – however worthy those objectives may be – there is a potential sacrifice of equity, or a perception by taxpayers that the system is not fair.

1.126 I was therefore pleased that the Honourable Michael H. Wilson, Minister of Finance, chose to address these matters in his 18 June 1987 White Paper on Tax Reform:

> Special preferences help some taxpayers, but at the cost of higher tax rates that hurt others. As a general principle, the government should refrain from using the tax system to subsidize particular types of investment activity. Such subsidies introduce distortions in economic decisions and inequities among taxpayers. Where incentives remain, they should serve well defined objectives, and should endeavour not to bias choices among similar types of economic activity.

1.127 In last year's Report, I specifically commented on the rather unedifying scenario of officials in the Departments of Finance and National Revenue-Taxation becoming engaged in defending the original intent of tax-funded programs against the encroachment of advisers and experts who seek to broaden tax avoidance opportunities. So I was again particularly pleased to see that the Minister of Finance is introducing measures to eliminate opportunities for this kind of tax avoidance.

1.128 The necessity for these measures is underlined by a matter raised in an important Audit Note discussed in full in Chapter 3. It examines the $200 million payment made by the Canada Deposit Insurance Corporation to facilitate the sale of the Bank of British Columbia to the Hongkong Bank of Canada.

1.129 The strange aspect of this transaction is that the $200 million dollars was not paid direct to the Hongkong Bank of Canada. Instead – in a fairly complex series of procedures which are discussed fully in the Audit Note – the money made an off-shore circle, from the Canada Deposit Insurance Corporation to the Hongkong and Shanghai Banking Corporation in Nassau, Bahamas, and then back to the Hongkong Bank of Canada.

1.130 I am obliged to conclude that a principal reason for these circuitous transactions, and in particular for making the $200 million payment off-shore, was to attempt to avoid making the payment subject to Canadian income taxes.

1.131 What particularly concerns me is that officials of the government and the Canada Deposit Insurance Corporation were involved in negotiating an agreement that was structured in a way that looks to me like tax avoidance.

1.132 I clearly recognize that there is another facet to this affair. Bailing out the Bank of British Columbia can be viewed as a highly responsible action by the Canada Deposit Insurance Corporation, which may well have resulted in avoiding all the grief and actual losses - many of them ultimately taxpayers' losses - that accompanied the failures of the Northland Bank and the Canadian Commercial Bank. And it can be argued that the desired end, the rescue of the Bank of British Columbia, justified the means - the attempt at tax avoidance.

1.133 That is not a view that an auditor can take; in the long run another result is a further loss of credibility for the Income Tax Act. And in a self-assessing system, if Canadians come to believe that the Income Tax Act and its administration are unfair, the eventual consequences will be far more serious than the failure of a chartered bank.

Defining Clear Objectives

1.134 Another issue I have discussed in previous reports is the lack of clarity in the objectives of certain programs. Is the objective to meet a need identified by the department? Or is the objective to meet another kind of need - to provide, say, employment in a specific region of the country? Or are the objectives a little of each of these things? My concern as auditor has never been to question the legitimacy of any of these possible objectives. My problem has been that if the objective is ill-defined it becomes nearly impossible for me to provide Members of Parliament with any assurance that there has been due regard for value for money in achieving whatever the objectives may be. My appeal has been for ministers and departments to state as clearly as possible the true objectives of programs.

1.135 There is something that further troubles me, especially in light of what I have said about the values of public servants. When managers become convinced that a substantial number of the programs they are required to initiate and administer exist to satisfy unstated objectives rather than stated objectives, one can hardly blame them for becoming cynical about urgings to achieve economies. Nor can one blame them for tending to point to the political environment in which they must operate when they are challenged on some inefficiency or cost overrun.

1.136 Successful organizations, both in the public and private sectors, have found that stating objectives and desired outcomes as clearly as possible and gaining understanding and acceptance for them from all the people involved contributes to performance that is of high quality, yet is achieved at reasonable cost. So, in more ways than one, clarity of objectives contributes significantly to achieving value for money.

1.137 I am therefore much encouraged by two things in my Report this year, one of a generic nature, the other specific. My more general observation relates to that decision to give departments increased managerial autonomy. One aspect of that decentralization is the establishment of a framework that includes specifying what a department is to accomplish within a given time. With all objectives more precisely defined, it should become easier for me to provide information to Parliament whether due regard was given to value-for-money considerations.

1.138 The particular matter that I also find encouraging is reported in our audit of major capital projects in the Department of National Defence (Chapter 9). As Canadians know, when these often huge capital projects are being undertaken, a determining consideration by the government is the beneficial economic impact they can have on whichever region of the country is chosen for, say, the construction of a frigate or the maintenance of a fleet of military aircraft.

1.139 Our 1984 audit of the Department of National Defence discussed the importance of these non-military objectives, and we recommended that intended economic benefits be spelled out in the Department's contracts. Subsequently, the Public Accounts Committee recommended that non-military objectives be identified in the Department's Part III of the Estimates and that their attainment be monitored and reported.

1.140 These recommendations have now been implemented, and the objectives are being reported in Part III. Our audit goes on to recommend that wherever it is reasonable to do so the Department should, in addition, identify for Members of Parliament the direct and indirect costs associated with achieving these other objectives. However, what is clear to me is that Members of Parliament already have much improved information for weighing the relative importance and value of the military and non-military objectives built into these very substantial projects.

1.141 It is a good sign. I hope, before I end my term as Auditor General, that this clarification of objectives will have been achieved throughout government. It will go a long way in helping to ensure that due regard is given to value for money in achieving what is often an array of goals. And I believe that clear and well defined objectives can also dispel much prevailing cynicism about the ways of the bureaucratic process. Canada and Canadians cannot afford such cynicism. As I wrote at the beginning of this chapter, government is necessary, and we should all be working to make it the best government possible.

Information for Parliament

1.142 An important role of the Auditor General is to assure Parliament that the information it is provided with, from a variety of sources in the government, is fair and represents complete reporting. The magnitude and complexity of government programs make this a massive task. And this sheer size represents a problem for Members of Parliament. It is clear to me that MPs now receive more information – and in more detail and with more depth – than ever before in Canadian history. But is it useful and useable information?

1.143 **The Estimates Part III.** Our Financial Management and Control Study finds that the Part IIIs of the Estimates are repetitive, hard to read and contain irrelevant information. However, the Part IIIs are still the best instrument Members have for judging the validity and worth of individual government programs. If, as our financial management and control chapters imply, what goes into the Part IIIs – and their presentation – needs to be improved, then that becomes an urgent priority. So convinced am I of the importance of the Part IIIs that I have set up a study that is looking at everything from how they are prepared to their actual impact. Its results will be included in next year's annual Report.

1.144 Meanwhile, the staff engaged in the study have already been interviewing Members of Parliament about their use of the Part IIIs. One thing emerging from these interviews is that MPs do make use of the Part IIIs to get a quick understanding of a department or a particular program. Members are also convinced of the Part IIIs' value as reference documents and of their importance in exacting accountability from the government. The fact that the information in them is public helps to keep the system honest.

1.145 But we are also discovering that many MPs find that much of the information in the Part IIIs is not immediately relevant to their daily work. This seems to be largely because the Part IIIs are systems-based and contain a lot of information that is already history. The minds and lives of MPs are geared to the present and immediate future, and they are interested hardly at all in the systems that underpin departmental activities. Instead they are concerned with the results of programs, their outputs and outcomes, and their impact on people.

1.146 In brief, Members of Parliament are asking that the Part IIIs provide a quick and clear understanding of what departments have done and what they intend doing. I hope that what we will be reporting in 1988 will prove a useful contribution to improving the Part IIIs.

1.147 **Federal Government Reporting Study**. A major objective of our Federal Government Reporting Study (FGRS), conducted by my Office and the United States General Accounting Office, was to identify the financial information about federal governments that users need – in particular, legislators. The most significant overall finding of the two-year study was that virtually all the users consulted required a comprehensive but succinct annual financial report. Illustrations of what such a document might look like for the Governments of Canada and of the United States, together with a Summary Report of the study's findings, were published early last year.

1.148 In September 1986, the fourth and final FGRS publication, the Detailed Report of findings, was completed. It contained the three documents published earlier, together with separate chapters on findings for each of the six user groups studied and a full explanation of the approach and methods employed.

1.149 Reaction to FGRS has been positive. The Public Accounts Committee considered the study's findings at public hearings in 1986 and 1987. Members expressed interest in having the government prepare and publish an annual financial report along the lines illustrated (see the Eighth Report of the Committee included in Appendix C). The Comptroller General of Canada explained that FGRS findings will be thoroughly explored with the President of the Treasury Board, the Minister of Finance and the Receiver General. He indicated that a substantive progress report could be provided to the Committee in one year with a final report on the government's position in two years. Findings have also been provided to and discussed with the Canadian Institute of Chartered Accountants' Public Sector Accounting and Auditing Committee, which is generally supportive.

1.150 FGRS findings have also been presented and discussed internationally. In September of last year, the International Consortium on Governmental Financial Management hosted a two-day conference in Washington, D.C., that focused on our work. In March of this year, FGRS was a major theme at an international symposium on governmental accounting, auditing and financial reporting organized by the University of Illinois at Chicago. The findings are also being considered by the International Organization of Supreme Audit Institutions and by the International Federation of Accountants.

1.151 While these are all interesting developments, my key concern remains that Members of Parliament and other users should have at hand an annual financial report on the activities of the federal government that is concise, credible and useful. Our study has identified this need and gone a long way toward illustrating the kind of financial report that MPs and others would find useful. One item on my agenda for my final three years as Auditor General is to press for the essential FGRS concepts and specifically the proposed annual financial report to be adopted by the government.

1.152 **Audit of authority.** Parliamentary control over the public purse rests on the power to grant or withhold funds from the Government and specify the purpose for which the moneys granted may be spent. These principles are embodied in our parliamentary system and in the Financial Administration Act and implemented through enabling legislation and vote wordings in appropriation acts.

1.153 Over the coming years I plan to review the extent to which the precision of vote wordings in appropriation acts, enabling statute language and program definitions could be improved to provide for more effective parliamentary control over the public purse.

1.154 **Remissions.** Our audit of Revenue Canada - Customs and Excise (Chapter 5) reports another instance of insufficient information available to Members of Parliament. The issue raises concerns that are not unlike the problems related to income tax expenditures. Canada imposes customs duties on many goods imported into our country. The legislation is the Customs Tariff, an Act of Parliament. But, for a variety of legitimate reasons, where it is deemed that the payment of duty is inappropriate, exceptions are made. These tariff relief programs represent big dollars - several billions in any one year. Our audit focuses on tariff relief by way of Order in Council and the Duties Relief Act.

1.155 The whole discussion will be of interest to Members of Parliament. However, my particular concern here is that none of the three major sources which are intended to provide Parliament with information on government expenditures and programs - the Fiscal Plan, the Estimates, the Public Accounts - adequately deals with these remissions.

1.156 The overall result is that MPs are left largely in the dark on what is a kind of 'hidden budget' item. Our chapter includes recommendations for overcoming the problem. I am pleased to see that the Office of the Comptroller General has recently initiated a study that includes finding the best way of reporting on remissions in the Public Accounts. I will be monitoring progress by the Office of the Comptroller General and by the Department of Finance and Customs and Excise in providing adequate and appropriate information to Parliament.

1.157 **Information resources management**. The subject of information for Members of Parliament is another reminder of the significance of information in our information-oriented society. In previous annual Reports I have drawn attention to the need for government to view information as a costly and valuable resource, including both the information and the technology that produces it. As I indicated earlier in this chapter in my discussion of financial management information systems and the use of microcomputers, management of information resources has a major impact on economy, efficiency and effectiveness in government operations.

1.158 In this regard, I am encouraged by Treasury Board's 1987 Information Management Policy Overview in which the government formally recognizes, for the first time, that information and information technology are resources. To assure Parliament that value is being received from use of these resources, my Office has spearheaded development of methods for auditing the management of information resources, enabling auditors to address this area. It may be that we are reaching toward a time when information will be accorded the same attention as financial, human and physical resources. This is an important development. Both decision makers and operational managers need the information that is appropriate to the decision being made. Often they have either too little or far too much. Having precisely the information required will be a big step forward in achieving planned results and performance.

Canadian Broadcasting Corporation

1.159 **Successful recovery program.** In my last year's Report, I expressed my serious concerns about public funds being at risk because of the difficulties encountered by the Canadian Broadcasting Corporation in implementing a complex new financial information system. At the time of publishing last year's Report, the Corporation was implementing a recovery program. The actions undertaken during the year ended 31 March 1987 as part of the recovery plan enabled the Corporation to stabilize successfully the present components of the National Finance System, to restate its 31 March 1986 financial statements and to re-establish proper books of account. As a result, I am pleased to be able to state that the Corporation has provided to the government and, ultimately, to Parliament, a reliable account of its stewardship of public moneys for the fiscal year ended 31 March 1987.

Ongoing Programs and Future Commitments

1.160 The tariff relief programs I spoke of earlier raise another issue that I only touch on here. The Public Accounts reveal that remission orders amounting to more than $1 billion annually are being granted. And it appears that no one is evaluating whether these remissions are fulfilling the purposes for which they were originally issued.

1.161 A parallel situation is revealed in our audit of certain transportation subsidies, reported in Chapter 13. In the case of a number of these subsidies, changed circumstances over the years have radically altered the economic environment that led to granting the subsidies in the first place. And, once again, there seems to be little or no evaluation being performed to determine whether the subsidies are achieving their original objectives or whether there are unintended and even contrary effects resulting from maintaining certain subsidies.

1.162 Those examples link back to the observation from our Financial Management and Control Study that few measures have been developed or are in place to evaluate the effectiveness of many government programs.

1.163 But the programs do go on and on. And it is a political fact of life that when Members of Parliament approve a new project, they are in effect committing funds not only for the current year but for many years to come.

1.164 To this realization must be added the reality that emerges from my earlier discussion of the federal deficit, that the cost of any program is liable to be increased by the borrowing cost of the funds involved. For, as with an individual so it is with a nation; if one is already in debt, each new purchase eventually costs more than if one has cash in hand. All these things can contribute to a situation where the government of the day can find its options increasingly restricted in undertaking programs necessitated by present conditions.

1.165 That is a rather sombre scenario; that past commitments and escalating debt charges might eventually prevent a future government from governing in any real sense. Perhaps too sombre; but there is undoubtedly a long way to go to ensure that such a scenario never takes place.

1.166 Important initiatives have been carried out to improve financial management and control and to establish a climate where cost consciousness is a reality. But progress has been slow, and essential things remain to be done. My Report contains far too many examples of taxpayers' dollars continuing to be spent with no assurance that value for money is being obtained.

1.167 Still, my Report this year inclines me to a cautious optimism. The glass is half full rather than half empty. What needs constant vigilance is the recognition that achieving value for money in the programs of today is the best guarantee that future governments can provide the services Canadians desire and deserve through all the years to come.

1.168 Perhaps this Report can make its own constructive contribution to that purpose.

ANNEX TO CHAPTER 1
Some Key Deficit Concepts

The federal deficit in any one year reflects a wide range of information about the financial condition and performance of the government. More than one measure of the federal deficit is thus needed in order to understand its make-up. The text of my remarks draws on the following concepts and definitions.

- **The Deficit: Public Accounts Basis.** Total expenditures minus total revenues in any one fiscal year as recorded in the Public Accounts of Canada. Because I audit the Public Accounts, I have used them as the starting point for my discussion. However, because some of the information I needed was more readily available in the National Accounts, I have also used them where necessary.

- **The Deficit: National Accounts Basis.** Total expenditures minus total revenues, but on a calendar year basis and with certain major accounting differences, including greater use of accrual accounting. Although the pattern of change is very similar between the two, the National Accounts provide a more convenient basis for certain types of economic analysis.

The deficit can be separated into a number of elements, each of which addresses a particular question about the government's financial condition. For a start, it is useful to distinguish the primary deficit from net interest payments.

- **The Primary Deficit.** Expenditures (excluding interest paid on the national debt) minus revenues (excluding interest earnings on financial assets). This measure focuses on the ability of government to pay for basic programs without additional borrowing.

- **Net Interest Costs.** Federal interest payments less interest receipts. This amount represents the net annual cost of financing past government borrowings.

The deficit can also be broken down into two additional elements, one reflecting the discretionary fiscal choices of government (the cyclically-adjusted or "structural" deficit) and the second reflecting the impact on the deficit of economic conditions generally (the cyclical deficit).

- **The Cyclically-Adjusted or "Structural" Deficit.** The estimated federal shortfall between revenues and expenditures (National Accounts basis) that would apply under economic conditions of full (or "normal") employment. A deficit that exists under conditions of full employment is sometimes referred to as a "structural" deficit. I have referred to this in the text of the chapter as a **persistent** deficit, the deficit that would exist even if our economy had been running more or less at its full potential.

- **The Cyclical Component.** The estimated component of the deficit (National Accounts basis) that represents the federal budget's automatic response to changing economic conditions.

With these concepts, the total federal deficit can usefully be described as having three fundamental elements. First is the **cyclical component**. Its magnitude will depend on the performance of the nation's economy generally. Second is the **primary cyclically-adjusted component**, (the structural deficit minus net interest payments). Its magnitude will reflect the discretionary fiscal decisions of government. And third is **net interest payments**, representing the financing costs of the net financial liabilities of the government.

The breakdown of the deficit into its structural and cyclical components is by no means straightforward. It depends on the definition of full (or "normal") employment, the choice of revenues and expenditures to be subject to cyclical adjustment and estimates of the **sensitivity** of these revenues and expenditures to changes in economic growth. Nevertheless, by focusing on changes in these components, users of the information can obtain meaningful insights into the financial condition of government that would otherwise be blurred by more conventional deficit measures. In particular, the user can distinguish between structural improvements in the deficit that arise from direct government action and cyclical improvements that simply mirror improvement in the economic performance of the nation.

GENERAL SUMMARY

GENERAL SUMMARY - 1987 ANNUAL REPORT

2.1 This chapter contains summaries of most of the chapters in the 1987 Report of the Auditor General to the House of Commons. The summaries are set out in the order in which chapters appear in the Report. Chapter 1, Matters of Special Importance and Interest, Chapter 3, Audit Notes, and Chapter 16, Follow-up of Recommendations in Previous Reports, are not summarized here.

2.2 The summarized chapters in this year's Report are:

Chapter 4 - Financial Management and Control Study
Chapter 5 - Revenue Canada -Customs and Excise
Chapter 6 - Department of Agriculture
Chapter 7 - Department of Energy, Mines and Resources
Chapter 8 - Department of External Affairs
Chapter 9 - Department of National Defence -Major Capital Projects
Chapter 10 - Department of National Defence -Materiel Support
Chapter 11 - Department of Supply and Services
Chapter 12 - Department of National Health and Welfare
Chapter 13 - Department of Transport
Chapter 14 - Employment and Immigration Canada
Chapter 15 - Special Audits
  - Reporting Losses Due to Fraud and Illegal Activity
  - Risk Management Audits
  - Major Capital Projects
  - Emergency Preparedness
  - Microcomputers
Chapter 17 - Management Category

CHAPTER 4 - FINANCIAL MANAGEMENT AND CONTROL STUDY

2.3 Financial control means that assets owned by the government should be properly recorded and protected, accounting data should be accurate and reliable, and funds should be spent only for those purposes stated and within limits approved by Parliament.

2.4 Financial management means that decision makers, such as Parliament, ministers and departmental managers, should know the financial implications of their decisions. Operations should be carried out with due regard to economy, efficiency and effectiveness, and information should be available to hold managers accountable for their use of resources.

2.5 Financial management and control are not separate from management. They are an integral part of the responsibility of departmental managers. The financial function has a special role to play because of the need to provide managers with the information they require.

2.6 **Purpose of the study.** Between 1974 and 1976 the Office of the Auditor General carried out a major study of financial management and control in government. It concluded that the government had lost, or was close to losing, effective control of the public purse. Since then, the government has responded to virtually all the recommendations made at the time. We believed that, after 10 years, it was appropriate to review the effect of the changes on financial management and control. Also, in an environment of restraint such as we have today, good financial management and control are needed to make sure the government gets the best value for the money it spends.

2.7 **Audit scope.** We looked at nine departments that we believed were representative of the operations of government. Within these departments, we examined how they carried out the different elements of the financial management cycle. There are separate chapters on eight of the departments in this year's Report. We reported on Veterans Affairs last year.

Financial Control

2.8 We found that significant improvements have been made in financial control since our earlier study. There are systems and procedures that provide basic financial controls, and there is no indication that fundamental control weaknesses are widespread.

2.9 But even though basic financial controls now exist in most departments, there are still some problems. Control weaknesses were identified in all departments. In most cases, these are not a threat to fundamental financial control, but they need to be corrected.

2.10 We are generally satisfied that departments have adequate mechanisms to ensure that they don't exceed levels of spending authorized by Parliament and that money is spent only for the purposes intended.

2.11 One element of financial control that has to be improved is the safeguarding of assets. The government owns a diverse range of assets. Right now there is no information readily available on the total cost or value of the government's assets. This leads to problems not only with controlling assets but also with managing them. We found that asset management systems and practices often do not provide assurance that assets are properly controlled and safeguarded and that their use is monitored.

Financial Management

2.12 In our opinion, financial management is not yet satisfactory. Although we are encouraged by the progress made by a number of departments, we found problems with the information available to departmental managers, to central agencies, and to Parliament. They need this information to understand the financial implications of decisions, to ensure that operations are carried out with due regard to economy, efficiency and effectiveness, and to provide for financial accountability. Some of the tools exist. Others need to be adapted and refined. All need to be used better.

2.13 **Financial information for the allocation of resources.** We found that information provided on major capital projects and on new program initiatives is improving, but it is still inconsistent in quality. Some departments have central groups that provide a strong internal challenge to project proposals before they are submitted to Treasury Board, and this has led to a better appraisal of a number of projects. But even strong internal challenge depends on complete information and a clear definition of need. This isn't always available. Few departments have established these strong mechanisms for internal challenge. The quality of information therefore varies considerably. One area that particularly concerns us is the information provided by departments in their requests for funds for new automated information systems. Many of the project proposals that we've seen overstated the benefits and understated their costs by a large margin.

2.14 Improvements are needed to ensure that program initiatives and smaller capital projects, especially systems development projects, are supported by sufficient financial information and challenged by those responsible for allocating scarce resources.

2.15 We found that most budgets are based on prior years' costs. This information is important but it is not sufficient. We found that statements of results are imprecise, information on the costs of products and services is still inadequate, performance indicators often don't exist, and service levels are often not defined. Where the nature of operations made this type of data inappropriate, we frequently didn't find good proxy measures. These shortcomings mean decision makers don't have the information needed to ensure that they allocate resources in the most effective or efficient manner.

2.16 In several departments we found very detailed work plans in support of budgets. This is much more than existed a decade ago, but they still need to be improved if they are going to be useful financial management tools. We found that to do this they would have to link the resources being requested more closely to the specific results being planned.

2.17 One of the problems we've found on the planning and budgeting side is the government planning system itself. It is a complex system that is based on the concept of linking program objectives, results and resources. There have been several problems in trying to do this. One is that programs often have multiple or unstated objectives and, as a result, managers have considerable difficulty in translating these objectives into clear, measurable and attainable statements of purpose. Another is that it is often extremely difficult to aggregate the results of diverse lower-level activities to produce meaningful statements of results at the activity or planning element level.

2.18 **Financial information for managing operations.** Most departments have the information needed to ensure that they don't overspend their budgets. But they often don't have good information to manage their resources. Financial and operational data are rarely pulled together. As a result, managers seldom have the information needed to know whether their operations are economic, efficient and effective.

2.19 At the Program level, few ongoing measures of effectiveness have been developed. Even at the operational level, there are few ongoing effectiveness measures.

Program evaluation, which should provide periodic reviews of effectiveness, has not yet covered most of the activities of departments.

2.20 There is a lot of information available, but it is frequently not the right information. For example, the information available on assets is often poor or incomplete. In terms of managing efficiently, we have found that, with few exceptions, information on the efficiency of operations is inadequate. The proportion of resources covered by performance measures is low. Most performance standards are based on historical data, and there is no assurance that these represent efficient standards of performance.

2.21 We also found the information on costs to be inadequate. Information on costs is needed for almost all decisions. The kind of information may vary depending on what it is being used for - recovering costs, allocating resources, comparing similar operations, privatizing operations, or making operational decisions. But we found that cost information is often not available.

2.22 One way of ensuring that appropriate financial management information is available is to build good information systems. We looked at how systems were developed within departments. What we found was not encouraging. There was a pattern of project failures, cost overruns, poor operating performance, duplication of effort and significant waste. And departments still often don't have the information they should have to manage their operations.

2.23 We found that major financial systems development projects have taken years to implement. They almost never come in on time or within budget. The decisions to proceed with systems are often made on the basis of incomplete estimates that are then ignored as systems are implemented. Project management in the systems we observed was deficient, and departments rarely kept track of full project costs.

2.24 **Information for financial accountability.** There are three levels of financial accountability - accountability to departmental managers, to Treasury Board, and to Parliament. It is the responsibility of managers to account for the manner in which they fulfil the financial responsibilities entrusted to them.

2.25 We found that financial accountability within departments is weak. Many departments have developed management contracts which are statements of performance negotiated annually with managers who are later appraised against them. There has been considerable effort made to develop these contracts, but their quality and content vary substantially both within departments and from one department to the next. Managers report periodically on their progress against the plans that form the basis for these contracts. Most of the progress reports that we reviewed discuss technical or operational outputs as well as certain administrative objectives such as affirmative action. But they don't act as financial accountability documents because they rarely provide the information that relates operational performance and financial performance. Thus, managers tend not to be held accountable for the efficient use of resources.

2.26 In the case of financial accountability to the Treasury Board, we found that to date there has been no comprehensive and systematic financial accountability mechanism between departments and Treasury Board. The recent initiative of Increased Ministerial Authority and Accountability (IMAA) was designed to fill this gap. Through a Memorandum of Understanding, IMAA sets out what a department is to accomplish within a specific time and what information it is to provide as a basis for reporting on its performance. We agree with the principle underlying IMAA, but we have a number of reservations.

2.27 Our main concern is that Treasury Board has stated that it is going to be relying on certain existing mechanisms – mechanisms that we have found don't work well. IMAA is based on a Memorandum of Understanding to be signed by the President of the Treasury Board, the Secretary of the Treasury Board, the Minister and the Deputy Minister of the department. It is based on a multi-year cycle with specific milestones. To make it work there has to be some stability in departments in terms of the tenure of senior managers. Last year, the Public Accounts Committee expressed concern over the current short tenure of deputy ministers. We share the concern. To achieve operational or strategic objectives requires continuity of direction, and recent history suggests that this is unlikely to occur.

2.28 **Ultimate financial accountability is to Parliament.** Parliament receives accountability information from a number of sources. There are the three volumes of the Public Accounts, the three parts of the Estimates, and the departmental annual reports. We concentrated on Part III of the Estimates and on the annual reports. We found that the information provided to Parliament has improved following the introduction of the Part IIIs. But there are still major weaknesses in the information provided for financial accountability purposes.

2.29 There is no doubt that Parliament now has more, better and more timely information on government programs. What Part III does well is describe what each program does. There is still room for improvement in the way departments describe how resources will be used to achieve results. Information on what has been accomplished with resources received in previous years is inadequate for purposes of accountability. We found the Part IIIs repetitive and hard to read. Their format is consistent, but this often results in general and unfocused information being provided to Parliament. Departments are not including important information in the Part IIIs on spending or on the financial implications of certain initiatives. There are problems with tracking major spending initiatives. Because Parliament is the custodian of the public purse, it is essential that Members of Parliament be given the information that they need to carry out their responsibilities. Although, the Part IIIs provide more information, further improvements are needed.

2.30 **Role of the financial function.** Financial management and control is part of general management and therefore the responsibility of line managers. But financial officers also have a special role to play in ensuring that managers have the necessary tools and information to carry out their financial responsibilities. We found that the roles and mandates, and therefore the effectiveness, of senior financial officers and the financial function are not consistent from department to department. Instead they are determined by the nature and the history of each department and by the attitudes and personalities of the people involved.

2.31 In the area that is specifically assigned to the financial officer – financial control – we found improvements. The financial function ensures that accurate financial data and adequate financial controls exist in most areas and that managers have the necessary information to ensure that money is spent for the purposes intended without exceeding the approved levels. But because financial officers do not have the information that integrates financial and operational data, they have generally not succeeded in providing information that is useful to program managers for purposes other than controlling spending.

2.32 **Role of central agencies.** Many of the weaknesses in financial management are specific to individual departments. In these cases, management in the departments needs to take the steps necessary to correct the shortcomings. But there are a number of weaknesses common to almost all departments. Many of these would not have occurred or would have been greatly reduced if central guidelines had been followed or if central agencies were doing what was stated in their mandate.

2.33 The guidelines and directives sent out by the centre are clear. But the monitoring performed by central agencies has proved to be inadequate or ineffective. There is little indication that the central agencies knew about the problems or, if they did, that they recommended or initiated corrective action. Certainly, the present monitoring and control process for the development of financial information systems does not work. There is no accountability mechanism in existence, although the Increased Ministerial Authority and Accountability initiative is intended to fill this gap. For it to work involves answering the question of what should be the dividing line between the responsibility of departmental managers and that of central agencies. Treasury Board needs to decide what those elements are that should be controlled and/or monitored, and when it should intervene to see that problems are corrected.

CHAPTER 5 - REVENUE CANADA - CUSTOMS AND EXCISE

2.34 **Background.** The Customs and Excise objective is to ensure that all duties, taxes and other relevant charges and levies are assessed, collected and, where appropriate, refunded; to control, for the protection of Canadian industry and society, the movement of people, goods and conveyances entering or leaving Canada as required to achieve compliance with legislation; to protect Canadian industry from real or potential injury caused by the actual or contemplated importation of dumped or subsidized goods, as well as by other forms of unfair foreign competition.

2.35 Revenue collection is an important responsibility of the Department. In 1986-87 it collected $20.6 billion in revenue.

2.36 The Department works in an environment of frequent legislative and rapid technological change. Possible sales tax changes and free trade negotiations could significantly affect the Department's operations in the future. The Department has developed a Person-year and Cost Reduction Plan to reduce its staff by 954 person-years by 1990-91.

2.37 **Scope.** Customs and Excise was part of the government-wide study of financial management and control. We documented, evaluated and tested the Department's revenue systems. We reviewed planning, budgeting and reporting systems. In conjunction with this work, we examined the Memorandum of Understanding. We reviewed the role of the financial function, and in particular the advice and assistance it provides in relation to initiatives. We examined the internal audit function. We also reviewed two financial information systems.

2.38 In addition, we reviewed remission programs designed to provide tariff relief to importers and Canadian industry or to facilitate international movement of goods and equipment.

Financial Control

2.39 **Tax revenue. Financial controls over revenue are adequate.** We concluded that for the fiscal year 1986-87, revenue collected was safeguarded and properly accounted for, and client accounts maintained by the Excise Branch were properly stated.

2.40 **Expenditures.** We observed no instances where funds were spent for purposes other than those authorized. The Department limited its spending to those levels approved by Parliament.

Financial Management

2.41 **Planning and budgeting. Customs and Excise has made progress in developing and implementing the government-wide planning framework, but improvements are needed.** The Department has defined its activities and their broad intent. But results and linkage statements and performance indicators need to be improved and incorporated into departmental planning, budgeting and reporting systems before the Operational Plan Framework can be used as the Department's basis for resource justification and accountability. The Department acknowledges that it needs to improve its results and linkage statements and establish measures of results in terms of level of service, productivity and effectiveness.

2.42 **Memorandum of Understanding.** Customs and Excise was the first department to sign a Memorandum of Understanding with the Treasury Board. The Memorandum reflects the Department's commitment to work with the Treasury Board to improve the departmental Operational Plan Framework and performance measures. These improvements are intended to be incorporated into the planning, budgeting and reporting processes and ultimately should enable better accountability to the Treasury Board. These improvements are necessary to meet the aims of Increased Ministerial Authority and Accountability (IMAA).

2.43 **Reporting.** In reporting to senior management the Department is taking steps to improve its reporting on revenue, on initiatives and on departmental performance. Part III of the Estimates for Customs and Excise did not adequately demonstrate the achievement of results or program effectiveness or justify the resources requested and used.

2.44 **Role of the financial function.** The financial control responsibilities being exercised by the financial function are appropriate. While there was adequate financial control, we pointed out a number of areas where, in our opinion, the financial function should play a stronger role in financial management. For example, the quality of financial analysis to support initiatives was weak.

2.45 **Internal audit.** We found that, overall, internal audit activities complied with the internal audit standards issued by the Office of the Comptroller General. Improvements could be made in the areas of audit planning and computer auditing.

Financial Management Information Systems

2.46 **Computer systems were not developed with due regard for economy and efficiency.** After expenditures of approximately $10 million over seven years for the Clientele Profile System, there is no integrated and efficient management information system in place to assist the Excise Branch in carrying out its regulatory functions. The opportunity for revenue improvement of $10 million per annum cannot be realized. The Financial Expenditure Control System, which is the other system we reviewed, is not complete. It has taken six years to develop the system. This is longer than would normally be expected for a microcomputer system of its size.

2.47 Systems development deficiencies were due to weaknesses in strategic planning and in senior management's monitoring and holding staff accountable for achieving results. In our opinion, the lack of an Automated Strategy Review prior to 1983 contributed to the fact that little progress was made in the development of the two systems we reviewed. The Department's EDP strategies, particularly those from 1984-87, lacked a number of critical features. In terms of monitoring project development, we found that senior management did not receive detailed schedules with predetermined deliverables, targets and costs. Senior management could not have monitored, taken corrective action and held project teams accountable with the information it received. Customs and Excise is establishing processes to resolve these weaknesses.

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Remission Programs

2.48 The Department of Finance is responsible for tariff and tariff relief policy including setting objectives. Customs and Excise is responsible for administering remission programs. Remissions can be used to reduce or eliminate duties and taxes otherwise payable. Remissions can also be used to facilitate international movement of goods and equipment. Our review of the financial management of remission programs was done in a similar way to that used to review direct expenditure programs.

2.49 **Parliament does not have adequate information to assess remission programs.** In 1985-86 approximately $1 billion in remissions was granted. We found no information in the Fiscal Plan or the Estimates on such things as the objectives of remission programs, the results achieved in the past and the results expected in the future. Members of Parliament do not have sufficient information to assess the relief given through remission programs and to hold the government accountable for the programs.

2.50 **The information on remission programs provided in the Public Accounts is not very meaningful.** Receiver General directives specify how to report remissions in the Public Accounts. We found that the information provided in the Public Accounts was not complete. Information on remissions granted to facilitate international movement of goods and equipment was not meaningful.

2.51 **Remission programs need to be evaluated in the same way as other government programs.** We found that neither the Department of Finance nor Customs and Excise was evaluating remission programs.

2.52 **Special temporary entry remissions were granted in the absence of legal authority.** Customs and Excise is required to collect duties in accordance with the Customs Tariff unless there is authority to remit the duties. Departmental officials normally allow special temporary entry remissions before receiving Order in Council authority so as to facilitate the international movement of goods. There is no legal basis to do this.

CHAPTER 6 - DEPARTMENT OF AGRICULTURE

2.53 **The Department of Agriculture is under pressure to improve financial management.** Our Financial Management and Control Study in the Department of Agriculture took place when major agriculture issues had to be resolved and when management practices were undergoing considerable change. For example, grain prices fell dramatically in 1986, and farm incomes in general became increasingly dependent on government transfer payments. Statutory programs, intended to be self-sustaining and actuarially sound, were in deficit. And the Canadian Wheat Board reported 1986 pool account deficits of some $201 million to be funded by the public purse. At the same time, the Department has been called upon to reduce annual operating budgets and to increase revenues.

2.54 We found the Department responding to these different pressures in several ways. Officials have participated in federal-provincial working groups on farm issues, such as farm financing. Branch structures and responsibilities were being realigned, and senior managers were redefining branch priorities and goals. Also, new senior management committees were formed in 1986 and were refining objectives and tasks. The Department was rebuilding its Operational Plan Framework and changing financial planning procedures to ensure a linkage between individual branch plans and departmental strategies. In response to the recommendations of the 1985 Nielsen Task Force, the Department was also working on market-oriented, commodity-based strategies.

2.55 The Department is working to make its management more cohesive. It completed a review in 1986 to identify opportunities for savings in administration, and it issued a strategic direction document in April 1987. The Department met a 1986-87 budget reduction target of $75 million. It is expected to absorb a further reduction of some $100 million over the next three years. Although cutting costs encourages better resource management, it may only be deferring problems. Maintenance of buildings and replacement of research equipment have lagged and long-term development agreements are not fully funded. The Department is aware of these problems and is discussing them with the Treasury Board.

2.56 Until the new management structure and processes are fully operational and the present deficiencies have been overcome, financial management and control systems are not equal to the pressures of the current operating environment. However, the Department is aware of the deficiencies and is working on them.

2.57 **There has been progress since our 1975 study, but further improvements are still possible.** Most of the matters reported in the 1975 Financial Management and Control Study have been addressed. Internal audit, in particular, has become stronger. But some problems have been only partially corrected. For example, the new financial manual is silent on the allocation of responsibility for resource management between finance and program management. Amounts receivable from producers still remain outstanding for extended periods. And capabilities for determining costs and rates in respect of cost recovery need to be developed further. Accounting control over inventories has also not been implemented, and deficient control over equipment, supplies and materials inventories is often reported by internal audits.

2.58 The financial allotment control system has worked reasonably well. The problems in this area include limited time to replace the present financial information system before the current data processing agreement terminates, widespread use of informal financial information systems, and a backlog in central systems development. The Department lacks information on the allocation of management information resources to meet information priorities in a cost-effective manner.

2.59 Until an accountability framework is defined and implemented through financial and performance measurement systems, the Department cannot effectively show the relationship between planned resources and results and those actually spent or achieved. Moreover, standards for assessing managerial performance against budgets need to be specified to ensure consistency in appraisals and accountability for managing resources.

2.60 Work planning systems are fairly well developed, but they lack good costing capabilities. Work plans produce considerable information, but they are not well integrated with primary financial information systems.

2.61 Progress on cost recovery was slow between 1975 and 1984, but the Food Production and Inspection Branch has recently negotiated agreements with certain industry groups, and a new departmental policy on cost recovery was issued late in 1986. The rates for recovery currently lag behind actual costs. We think this is partly because there is no systematic reporting whereby amounts recovered under existing agreements and rates can be compared with actual costs. The Research Branch is now starting to look at cost recovery options.

2.62 **The Department is improving its management of capital assets.** The Department has recently undertaken several initiatives to integrate the management of capital assets with program needs. Until this transition is complete, the Department's ability to manage capital assets is limited. The Department recognizes the deficiencies we've observed, which include:

- at the corporate level, there are limited means of measuring and monitoring maintenance activities and a lack of current and accurate information on what assets exist, how they are used and whether they are available for use;
- incomplete life-cycle costing for capital projects and inadequate needs analysis in support of decisions to construct new facilities; and
- lack of evaluations following completion of capital projects and difficulties in controlling capital budget positions at or near year end.

2.63 **The partnership between the financial function and program management needs to be stronger.** Program and financial managers do not meaningfully consult about the financial implications of program goals and the use of resources. We are not suggesting that financial officers should make program decisions. However, such decisions would benefit from complete and timely information and advice so that managers know the full financial implications of their decisions. The Department has not emphasized independent challenge of spending and resource allocation by the senior financial officer. Monitoring by the senior financial officer of management improvement projects was discontinued in March 1986, and training in financial skills is not intensive.

2.64 The financial risk is potentially high in transfer payment programs such as Western Grain Stabilization, Crop Insurance, Agricultural Stabilization and ad hoc programs like Crop Drought Assistance and the Special Canadian Grains Program. Even though the financial stakes are high, financial advice is not always sought or provided. Our 1986 comprehensive audit reported a lack of information and analysis for managing the Western Grain Stabilization Fund and Crop Insurance plans. Our tests of the large annual transfer payments made by the Department showed overpayments and errors of $4.2 million over several years. And there was questionable compliance with authority. Similar more recent instances are noted in Chapter 3, Audit Notes.

2.65 **Financial management and control over grants and contributions is weak.** Financial management and control problems are most visible in the area of grants and contributions. We reported several deficiencies in financial management and control in 1986. This year we observed additional problems. Payments totalling $12.2 million for crop drought assistance were given post-approval by Treasury Board. These payments diminished the cost-effectiveness of the drought program because 6,080 producers received compensation they were not eligible for under the terms specified for drought assistance. Parliamentary appropriations were exceeded in respect of the Canadian Forestry Service Program by

$1.3 million. A further excess of $1.6 million would have been reported had payment claiming documents been promptly received and processed.

2.66 The sale of product inventories and disbursement of funds by the Agricultural Products Board were made in a manner inconsistent with the Financial Administration Act and contrary to the Board's enabling legislation. Also, accelerated payments of $1 million in contributions were made to an educational institution (now being recovered).

2.67 There was an inconsistency in calculations for the 1985-86 grain corn support program under the Agricultural Stabilization Act leading to payments being greater than necessary by approximately $880,000.

2.68 Fundamental problems came to light when we reviewed the $1 billion Special Canadian Grains Program involving the largest single payment ever to Canadian farmers. The program has been financed by way of Supplementary Estimates for the 1986-87 ($300 million) and 1987-88 ($700 million) fiscal years. Parliament had little or no information in the Supplementary Estimates to assess payment targeting or measure farmers' income shortfall. Neither could it fully review program terms and conditions and the cost of other support programs to grain farmers or evaluate the use of contribution funds already provided to the Department of Agriculture.

2.69 Although the program has been officially classified and reported as a contribution, it has the characteristics of a grant. Also, implementation policies and practices normally associated with a contribution were in the main not met.

2.70 Supporting analysis and option considerations were completed only after the $1 billion was committed. We could not determine how this number was calculated.

2.71 **There is a lack of comprehensive information for Parliament.** It is difficult to determine the total cost of all federal agriculture programs. The information is scattered in the Estimates of several departments and in the annual reports of several Crown corporations. We believe it would be useful to draw this information together and present a consolidated picture to Parliament. This could be done in the Main Estimates or in the annual report of the Department of Agriculture.

2.72 Our 1986 comprehensive audit of the Department reported opportunities to improve the Department's disclosure of performance measurements for accountability purposes. In terms of financial information, the Main Estimates for 1987-88 made only a footnote reference to the $700 million in transfer payments under the Special Canadian Grains Program and did not disclose the estimated $1.4 billion deficit in the Western Grain Stabilization Fund.

CHAPTER 7 - DEPARTMENT OF ENERGY, MINES AND RESOURCES

2.73 We found both strengths and weaknesses in financial management and control in the Department of Energy, Mines and Resources.

2.74 At the corporate level, the information available to plan, manage and report on operations is not sufficient. The Operational Plan Framework does not specify intended results. This is partly because of the difficulty in aggregating the wide variety of tasks found in each activity into overall results measures. Consequently, at the corporate level, EMR cannot link resources to expected program results. Nor are resource levels for ongoing activities critically challenged each year in relation to the level of service or work anticipated.

2.75 At the branch level, the information in work plans and progress reports compensates for some of these shortcomings. These plans generally link resources by specific projects or outputs and provide a reasonable basis for managing EMR's operations and for establishing internal accountability. This applies particularly to the larger contribution programs EMR has managed over the past four years.

2.76 But there are inconsistencies in the quality of information used to plan, manage and report on new initiatives.

2.77 Accountability to Parliament has been improved but not fully achieved through Part III of the Estimates. The Part III does not disclose intended results for each EMR activity or provide sufficient linkage between resources and results. Nor does it disclose the extent to which program objectives have been achieved with the resources previously provided. Although information is often available to do so, EMR seldom defines measurable goals in Part III or indicates how long funding will be required before targets are achieved.

2.78 There have been significant improvements in financial control since our 1974-76 government-wide study. Existing financial controls within EMR provide reasonable assurance that public funds are protected and that accounting records are accurate and reliable. They also provide reasonable assurance that money is spent for the purposes intended and that spending is limited to the levels approved by Parliament. However, controls over equipment assets need to be improved.

CHAPTER 8 - DEPARTMENT OF EXTERNAL AFFAIRS

2.79 Our audit of the Department of External Affairs focused on the common administrative services – Corporate Management, Finance, Property Management, Personnel, Internal Audit, Program Evaluation, Telecommunications and Records Management. The headquarters portion of these services has a budget of $215 million. Of the 7,800 people working in the Department, almost 3,300 are involved in providing these administrative services.

2.80 **Financial management and control.** The Department of External Affairs has made significant improvement in financial management and control since our 1982 audit. However, there are further improvements required, some of which management is currently undertaking.

2.81 The planning process requires a number of improvements, such as the development of alternative management strategies, ensuring that operational plans are precise enough to use in managing the operations and ensuring that the implementation of the plans is properly monitored. The Department is gradually changing the planning process to add these features.

2.82 Financial information at External Affairs is produced on three separate systems that have evolved over time. This poses problems in terms of compatibility, duplication and aggregation of information. The current arrangement, although less efficient than an integrated system, meets most managers' needs for information for financial control purposes. The Department is introducing a new system (FINEX) to eliminate the need for other departmental systems.

2.83 Financial reporting and monitoring of monetary assets require further improvement. We found many discrepancies and errors in the working capital advances to missions, in records of medical loans to individuals and in security deposits. As well, there was no central register of debentures granting "right of access" to clubs or schools.

2.84 The Department's records of materiel supply and control need to be improved. Surplus materiel was often unrecorded, and information needed for headquarters decision making was often not available. The needed information is not being gathered in a timely fashion or being provided to the people that need it. As a result, senior management cannot be sure that the current and requested levels of minor capital funding will enable the Department to meet its needs economically, efficiently and effectively.

2.85 **Real property management.** We found many improvements in the Department's management of real property around the world. However, further improvement is required in defining responsibilities for budgeting and monitoring overall departmental accommodation costs and for ensuring that standards are adhered to. This lack of definition of roles has resulted in weaknesses in the accommodation planning process, ad hoc monitoring of staff quarter costs and of adherence to standards, and delays in issuing guidelines to missions.

2.86 The Department has proposed to Treasury Board new standards for staff quarters that are more generous than previous standards. It has delayed a major program of acquiring staff quarters pending approval of new size guidelines. Once the issue of acceptable accommodation standards is resolved, the Department will have guidance on acquisition and disposal actions.

2.87 The Department, in its Long Range Capital Program, has spent $250 million of the $321 million approved since the Program went into effect in 1974. Since our 1982 audit, External Affairs has established a committee on accommodation priorities. We found the process to arrive at priorities could be improved if the information provided to the committee were better organized and included economic justifications. In addition, missions need to develop better information on their accommodation needs to assist in setting priorities.

2.88 Once priorities are set, the Department needs to develop better contingency plans that can be put into effect should the projects with primary priority fall behind schedule. This would help ensure the optimum use of funds available for capital projects.

2.89 The main objective of the Long Range Capital Program is to increase Crown ownership of property, thereby reducing rental costs abroad. In recent years, the Long Range Capital Program has focused on the chanceries and official residences; few resources have been devoted to staff quarters. Consequently, staff quarters are usually rentals. For a variety of reasons, staff quarters have tended to be in the downtown areas of the major cities. In some instances, a downtown location is no longer justified. They are very expensive; for example, New York rents averaged $55,614 in 1986-97. Relocating some of these staff quarters could result in significant savings.

2.90 Treasury Board has given External Affairs a low authority level for purchasing or disposing of properties. It was established some 10 years ago. This means the Department cannot act quickly to purchase property since few properties cost less than the level allowed. Furthermore, the proceeds from a disposal cannot be used to acquire replacement property. As a result, managers are reluctant to dispose of property that may exceed their needs because they have no assurances that they will obtain replacement properties. We think that Treasury Board Secretariat should review External Affairs' authorities to increase flexibility in managing its real property.

2.91 **Foreign service directives.** Foreign service directives are the basis for compensating foreign service employees for the different working and living conditions abroad. The directives form a large and complex document which is negotiated as part of foreign service collective agreements. We believe the Treasury Board Secretariat should evaluate the foreign service directives to determine the extent to which they are achieving their intent.

2.92 For the three directives we examined in depth, we found that there was a significant level of non-compliance. In some cases this has resulted in unintended benefits to the employees.

2.93 Some directives require the employee to use leave. For example, the travel assistance directive requires than an employee take 10 compensatory days leave to receive the benefit of the directive. In 30 per cent of the cases we examined, there were errors resulting in incorrect leave records. Most of the errors favoured the employees. We question the integrity of the Department's leave recording system and recommend that the Department review it in depth.

2.94 **Telecommunications.** The Department has recently begun a project to computerize its telecommunications systems. The estimated cost is $111 million over seven years. This new system will have a major impact on employees and on methods of operation.

2.95 The Department has adopted an approach to this project where specifications and costs are not fully defined until implementation is well under way. We believe that this is a high risk approach and may result in significant cost increases. Furthermore, in the Department's proposal to Treasury Board, several assumptions and notional estimates are made. These assumptions and estimates are to be validated in phase I of the project. As a result, the cost and savings estimates cannot be accurately projected by the Department at this time.

CHAPTER 9 - DEPARTMENT OF NATIONAL DEFENCE - MAJOR CAPITAL PROJECTS

2.96 In 1982 we reviewed several of DND's major management systems, including the Defence Program Management System that the Department uses to screen requests for funding equipment projects. We concluded that the system was fundamentally sound and that it included appropriate checks and balances. In 1984 we focused more on equipment acquisition projects to test specific elements of the total DND project management system, and we made a number of recommendations to DND on ways to improve the system.

2.97 The objective of this year's audit was to examine other aspects of the total project management system by once again reviewing how projects were managed through the identification, planning, implementation and in-service stages of their life cycle. We examined 10 major Crown projects each costing more than $100 million, and 3 others costing between $60 million and $100 million. We also examined a sample of smaller capital projects in the $5 million to $60 million range.

2.98 **DND has responded to our 1984 recommendations.** Of the 29 recommendations contained in our 1984 Report, 5 dealt directly with capital project management. Seven of the eight recommendations made by the Public Accounts Committee also focused on aspects of the management of capital projects.

2.99 Projects managed by the Department are often bound by fixed funding ceilings. But in many cases they involve a high level of technological complexity and uncertainty because weapons systems are often still being designed and tested during the acquisition process. In the case of the CF-18 fighter project, we reported in 1984 that this resulted in DND identifying a number of related, highly desirable projects budgeted outside of the main project. We made three recommendations dealing with fixed ceiling funding, reducing design uncertainties and reporting scope changes to Treasury Board. The Public Accounts Committee then made three related recommendations dealing with defining and disclosing project life-cycle costs. Action on all these recommendations is now complete and project life-cycle costs are being included in the Estimates Part III.

2.100 Our recommendations dealing with industrial benefits and non-military objectives highlighted the impact these have on defence spending. Non-military objectives achievement is now also reported in the Estimates.

2.101 In response to our 1984 recommendations, DND has taken steps to implement a project management system, has pursued the identification of alternative sources of spare parts, and has begun to perform internal audits of major Crown projects. The new White Paper on defence policy should assist the Department in putting in place the force structure called for in our 1984 Report.

2.102 **Projects are usually managed in compliance with the requirements of the management systems.** The elements of the management systems we examined during this audit are generally adequate, and projects are usually managed in compliance with the requirements of these systems. However, there are five areas where we believe that additional management attention should be given. These are discussed in the following paragraphs.

2.103 **Once again, we emphasize the need for complete and accurate project scope definitions.** In 1984 we expressed concerns about the need for clarity in determining what should be included in project scope, the need for improved life-cycle costing and the need to control project scope and cost changes. We also reported that DND had identified about $3.5 billion in additional desirable capital projects to support the CF-18 project. Of these, the associated capital projects considered to be essential would have cost $2.1 billion in 1984. Largely because of inflation, the costs of these essential projects has grown to $2.7 billion. During this audit we identified a life-cycle costing problem with the Howitzer project. Ammunition valued at about $40 million was removed from the project, despite the fact that DND policy states that "full operational stock plus two years training ammunition must be purchased" within the project's budget. We also noted that requirements have been established for two software facilities in support of the CF-18. At the time of our audit, one of these facilities was to be funded from the project capital budget, and the other was expected to be funded from outside the CF-18 budget.

2.104 **Related project objectives play an important role in these projects.** In almost every project we audited, non-military or strategic sourcing objectives played an important role in project planning, or in identifying and selecting potential contractors. For example, for the Tribal Class Update and Modernization Project, it was decided to discontinue the competitive bidding process and to sole source the implementation contract, partly on the basis of the urgent needs of the ship-building industry. For the CF-18 service contract, the contractor was selected largely on the basis of the opportunity for technology transfer and other economic factors.

2.105 DND is now reporting in Part III of its Estimates the extent to which non-military objectives are achieved. We have noted, however, that the pursuit of these objectives also involves a significant cost. We believe that, where it is reasonable to do so, the Department of National Defence should report the direct and indirect costs associated with achieving non-military objectives as part of its regular reporting of non-military objectives in Part III of the Estimates. Similarly, we believe that the cost of achieving strategic sourcing objectives should, where reasonable, be separately identified and reported.

2.106 **Sole sourcing reduces the benefits of competition.** Many of the projects we audited involved sole sourcing from qualified suppliers. For example, the Tribal Class Update and Modernization Project implementation contract, valued at $1.3 billion, was sole sourced partly to accommodate the urgent needs of the ailing ship-building industry. The rifles portion of the Small Arms Replacement project was directed to a Canadian supplier to support strategic sourcing, and the ammunition for this project was sole sourced for the same reason.

2.107 We are concerned that, without competitive bidding, the most cost-effective options may not always be obtained. We have recommended that decisions to by-pass the competitive process be supported by a full justification that specifies the costs, benefits and risks of doing so.

2.108 **Payment procedures are inconsistent.** A number of the projects we reviewed involved either very large down payments, payments in advance of contractual requirements, or payments in excess of contractual requirements. These situations involve a cost to the Crown, unless some form of off-setting benefit is obtained from the supplier. For example, for the CF-18 project, the Crown incurred imputed interest costs of $7 million as a result of early payments made during 1984 and 1985 and an additional $4 million of imputed interest costs resulting from higher than necessary milestone payments between 1980 and 1984. In some cases the Department obtained off-setting benefits for these payments; in other cases it did not.

2.109 We have recommended that the Department should establish policies and procedures to ensure that where high down payments, early payments and excessive milestone payments are necessary, off-setting benefits are obtained.

2.110 **The Department is standardizing its approach to warranties.** Warranties provide protection to the Crown in case of product fault being discovered either during a project or after it is completed. Warranty protection increases the cost of a project and, for highly sophisticated weapon systems, it is a very difficult job to define the optimum level of protection. The projects we reviewed therefore contain many different types of warranty provisions with varying degrees of protection to the Crown. We noted some instances where it is unclear whether the optimum warranty package was obtained. To maximize the protection from warranties, the Department, in co-operation with the Department of Supply and Services, is considering developing a standardized approach to warranties.

CHAPTER 10 - DEPARTMENT OF NATIONAL DEFENCE - MATERIEL SUPPORT

2.111 The ability of Canada's armed forces to survive and succeed in carrying out their assigned tasks in wartime depends on a number of factors. One is the logistics support given to the fighting units to feed the troops, maintain equipment, replenish ammunition, care for and evacuate the wounded, and bring forward replacements of people and equipment for those lost in battle. Materiel support is a Canadian term that describes the portion of logistics that deals only with supply, maintenance and transportation of materiel.

2.112 The logistics pipeline through which materiel support is provided is large and complex. It consists of several segments stretching from suppliers to the fighting troops, wherever they may be located. It could be several thousand kilometres long and involve multiple redistribution points. Even during peacetime, an enormous level of resources is acquired, maintained and transported through the materiel support system.

2.113 During 1986-87, the budget for replenishing and maintaining the inventory of close to 1.3 million different types of items was over $1.3 billion.

Materiel Support Framework, Procedures and Systems

2.114 For a variety of reasons, neither the materiel support system nor the logistics framework is now suitably developed for sustained conflict. We found that the materiel support system also exhibited significant difficulties in terms of economy and efficiency during regular peacetime operations. But the Department of National Defence has many initiatives under way to address our concerns in this area.

2.115 In the past 20 years, materiel support for the Canadian Armed Forces has developed in three distinct phases. During the first phase, before unification and integration, materiel support was decentralized. It formed an integral element of the three separate services. During the second phase, beginning in about 1969, materiel support became highly centralized under a civilian Assistant Deputy Minister in National Defence Headquarters. During this phase, the emphasis shifted from supporting combat operations to increasing efficiency under peacetime conditions. Much of the conceptual and procedural infrastructure essential for wartime support operations began to disappear. In the third phase, during the 1980s, there has been a renewed emphasis on having adequate systems, policies and procedures to augment and sustain the forces.

2.116 Throughout this audit, we noticed that officials at all levels in the Department of National Defence are beginning to promote the adoption of concepts, systems and practices to ensure a sustainable Canadian force.

2.117 **Canadian Forces Supply System.** This supply system is a major component of materiel support. It exhibits characteristics typical of an earlier period of development. The system was designed to be managed from National Defence Headquarters, using historical data and complex mathematical models to determine what should be purchased, when it should be bought, and how much should be distributed to each base and depot. The assumption was that this system of automatic computations would require minimum human intervention and management.

2.118 It is becoming apparent that the circumstances that led to centralization have contributed to implementing systems that lack the flexibility needed for field support operations. In the case of the Canadian Forces Supply System, much more manual intervention is now required than was intended originally. And it is increasingly apparent that basing decisions on historical usage data is not appropriate for military operations.

2.119 The largest initiative to improve this deficiency is DND's project to upgrade the Canadian Forces Supply System. We support this initiative, but we are concerned that until further work is done to define command and control relationships and materiel support doctrine, it will not be possible to define supply requirements clearly. If the supply system is upgraded without sufficient corporate direction and operational guidance to ensure that the resulting system will meet operational requirements, it may turn out, as it did with the current system, that technology ends up determining doctrine, rather than doctrine determining technology, as should be the case.

2.120 **Management information.** Management reporting is one of the most important tools in running complex materiel support systems like DND's. Even though it has many processes that provide information on elements of the materiel support system, DND does not produce a report on the effectiveness of the system as a whole. Reporting in the areas of supply, maintenance and transportation is fragmented and incomplete.

2.121 The centralization of support operations places a tremendous burden on the management information system. Information and feedback must travel long distances before they can be used by senior decision makers at Headquarters. Under a centralized system, most of the decision making required throughout the structure moves to the top. Officials can become overwhelmed by the volume of data with which they have to cope.

2.122 The Department recognizes this problem and has an initiative under way to develop an executive management information system that would link information from the sub-systems and aggregate it for use by senior decision makers at Headquarters.

2.123 Over the last 15 years, the materiel support system has seldom been included as part of military exercises. When it was included, it often performed poorly, even though it was usually only partially tested. With the growing interest in readiness and sustainability, it would seem appropriate that the materiel support system be regularly and rigorously put through its paces as part of operational exercises.

Acquisition

2.124 Departmental inventories include a wide range of repair parts and consumable supplies needed to support DND's people, equipment and weapons systems. When total holdings of any given item drop below a designated re-order level, a computer-generated "buy" instruction is reviewed by one of the supply managers responsible for inventory control. These supply managers validate requirements, initiate demands for acquisition, initiate repair action for repairable items, and ensure proper management of the inventory.

2.125 **Buying in advance of need.** For several reasons, including inadequacies in the Canadian Forces Supply System design, inaccurate data, inadequate training, and lack of review, DND sometimes ends up purchasing earlier than it needs to in order to meet current operational requirements. This results in additional carrying costs. We estimate that about $35 million in goods were purchased in 1986-87 in advance of what was needed to meet the

Department's current operational requirements. The additional cost to DND of carrying these items in inventory is about $7 million a year.

2.126 **Co-operative Logistics.** The United States Department of Defense offers an arrangement, known as Co-operative Logistics, where defence organizations in other countries can add their requirements to U.S. Department of Defense purchase orders. By doing so, they can take advantage of economies of scale and quality assurance arrangements.

2.127 In an attempt to support "buy Canadian" objectives, purchases have been directed to Canadian firms through the Department of Supply and Services rather than using the co-operative buying agreement. These Canadian firms often end up providing foreign manufactured goods at much higher prices.

2.128 We estimate that National Defence incurred additional costs of about $26 million in 1986-87 to purchase mainly foreign-made spare parts from Canadian suppliers. Of this amount $16 million was incurred in the purchase of goods from Canadian agents to meet urgent requirements. The other $10 million represents additional costs paid for items that were not urgently needed but that were acquired by the Department of Supply and Services in response to contract demands raised by DND.

Distribution Network Operations

2.129 Distribution of materiel at DND is carried out through a network ranging from the national level depot to the end consumer. This network is managed by a variety of groups, each with responsibility for one or more components. The wartime and peacetime planning, management and reporting demands on this system are extensive.

2.130 **Network management**. Many groups at National Defence Headquarters manage portions of the supply network. But no one group is responsible for providing strategic direction for the total system. As a result, questions such as the rate of redistribution are addressed in isolation and not from the perspective of total system management.

2.131 We found that of the requisitions filled at depots for delivery to bases, 33 per cent were sent out of the normal geographical delivery pattern. We estimate these out-of-region shipments cost National Defence more than $12 million a year. Although a certain amount of redistribution is to be expected, and actually contributes to system flexibility, we found no evidence of levels for redistribution being set and measured as part of a network-wide analysis of possible problem areas.

2.132 **Distribution operations.** Despite many supply facilities that are old and inefficient, supply officials do a reasonable job of satisfying peacetime supply demands. However, the system imposes delays and inefficiencies that sometimes cause staff in various locations to assign inflated priorities to requisitions in an attempt to force the system to react more quickly.

2.133 For example, except in the case of base-level requisitions classified as Immediate Operational Requirements, there is no procedure during the receipt process for recognizing materiel for which there are outstanding requisitions. In these cases, the materiel must be put away and the computer records updated before the outstanding requisitions can be filled.

Inventory Management

2.134 Supply managers are responsible on a day-to-day basis for ensuring that inventory items are acquired, stocked, repaired and issued in a timely manner and in sufficient, but not excessive, quantities.

2.135 **Inventory levels.** There is little overall management of inventory levels or analysis of the impact these levels have on system performance. Although indirect measures such as demand satisfaction exist, there are no procedures to measure and evaluate inventory decisions system-wide. Because authorized stock levels are not based on analyses of consumption, inventory can be unbalanced. This results either in higher than necessary levels of inventory at some locations or in redistribution to meet shortages at other locations.

2.136 **Excess stock.** The Canadian Forces Supply System manages approximately 1.3 million line items, valued at over $7.5 billion, using historical costs. Departmental reports indicate that between 10 per cent and 13 per cent of these line items are either inactive or slow moving. The estimated annual carrying cost of these items is about $240 million.

2.137 DND reviewed a computer-generated summary report on excess stock and identified $300 million worth of items being kept for emergencies, about $650 million worth that exceeded current requirements but that was being retained for possible use over the next 10 to 15 years, and potential disposable surplus of about $300 million.

2.138 We believe that reviews of excess stock should be a regular part of the Department's inventory management practice. This is especially true now that a depot expansion program is being initiated as a result of a lack of available storage space.

2.139 **Relative importance of items.** Under wartime conditions, the present Canadian Forces Supply System computer system would assign equal priority to purchasing any of the 1.3 million line items. Operational commanders would want to know that critical warstocks were being given special attention and that priority would be assigned to the most critical items.

2.140 National Defence has taken preliminary steps to categorize items used by the land forces in Europe. Only mission-critical items would be carried into the field during wartime; other items would remain back of the combat zone.

Supply Support to Maintenance

2.141 Operating equipment generates demands on maintenance which in turn creates demand for replacement parts. These are normally supplied from inventory. Some parts, including most of the high value parts, can be repaired. So when the old part is taken off the equipment, it is sent to be repaired or reconditioned, and then it is returned to inventory to be used again. This process is referred to as the "repairables pipeline".

2.142 **Repairables pipeline.** A major proportion of the value of spare parts inventory consists of "repairable" items - parts that can be repaired or reconditioned. When a new repairable part is placed on equipment, the maintenance personnel are expected to return the used part so that it enters the repairables pipeline.

2.143 The Department has encountered difficulties in controlling its repairables pipeline. These have contributed to shortages of some replacement parts for certain weapon systems. This is partly caused by pipeline delays in getting repaired parts back, and partly by supply managers that have the responsibility for managing the pipeline but that don't have the training to do so adequately.

2.144 **Relationship to supply.** An integrated materiel support system should bring together the aspects of supply, maintenance, and transportation. As stated earlier, this has not been achieved, and the Canadian Forces Supply System now operates independently of maintenance and transportation systems. This means that the quality of inventory decisions depends largely on the extent of communication between maintenance groups and supply groups.

2.145 Our sample of recent acquisitions for 1986-87 indicated that about $16 million of additional costs were incurred to meet immediate operational priorities. These were foreign-origin items that were available under Co-operative Logistics agreements, but they were acquired from Canadian agents to obtain shorter lead times. Had steps been taken to anticipate potential sourcing difficulties, these additional costs might have been avoided.

CHAPTER 11 - DEPARTMENT OF SUPPLY AND SERVICES

2.146 The Department of Supply and Services (DSS) was created in 1969 as a common service agency with responsibility to contribute to the overall efficiency, effectiveness and economy of the public service. The Department's role is to provide common administrative and procurement services in support of other departments and agencies.

Audit Scope

2.147 The scope of this audit was to evaluate management controls, both operational and financial, over the delivery of the Department's accounting, computing and other related services. These services are managed by the Management and Operational Services Sector and jointly delivered with the Regional Operations Sector. In this context our audit focused on DSS's ability to deliver cost-effective products.

2.148 Our audit was also designed to address the objectives of the Office's government-wide Financial Management and Control Study.

Management of Productivity

2.149 **External product costs.** The cost of products delivered by a service organization should be a major criterion in assessing its overall cost-effectiveness. Our audit compared the cost of the two largest DSS products, Public Service Pay and Public Service Superannuation, with the product costs of two provincial governments. By comparison, the provinces we reviewed have made substantially more headway in automating their Pay and Superannuation products, resulting in significantly lower labour and management and administration costs. Based on the unit product cost differences, we estimate that the combined annual cost gap for DSS's Pay and Superannuation products is in the order of $46 million. However, this cost gap cannot be fully eliminated by the federal government because of certain environmental factors.

2.150 **District Services Offices.** Our audit examined comparative productivity levels within the service delivery network for a sample of three DSO activities – data capture, accounts payments of the Government of Canada and Public Service pay. We noted wide variations in productivity between the various offices in the DSO network. In our opinion, there are long-term opportunities for productivity improvement in the range of 5 per cent to 9 per cent. Annual savings could range from $3.5 million to $6.5 million.

2.151 **Performance measurement systems.** Sound productivity management depends on reliable and timely information, including that produced by performance measurement systems. Such information provides the basis for allocating resources and controlling costs. The performance measurement systems in DSS's regional operations are ineffective. They fail to provide comparative productivity information; standards are not changed as processes change; and the extent of coverage is too low. Reports generated by these systems are produced too slowly and their delivery is unreliable.

2.152 As a result, DSS management does not have adequate tools to measure and report on the productivity in its regional operations, thus denying it the proper tools to control product costs.

Management of Automation

2.153 DSS operates one of the largest computer complexes in Canada. Effective management of automation is, therefore, an important contributor to the delivery of cost-effective products.

2.154 **Use and quality of automation.** Because computers represent a large annual cost to DSS and play such an important part in delivering DSS products, we reviewed both the extent of computer support and the degree to which this support met the needs of the people that must deliver the products. During our review, DSS personnel indicated that there are significant opportunities for automation. These relate not only to developing new systems but also to improving existing systems that do not deliver the intended results.

2.155 **Development of technology**. DSS is in the final stage of consolidating its data centres and creating a single technology environment. This initiative, although late in coming, is a progressive step and one that is necessary for achieving the benefits expected from automation.

2.156 **Development of systems.** Management controls over the planning and execution of systems development projects should ensure that the cost of automation development is minimized and that projected benefits are realized and reflected in lower product costs. Our review of system development projects indicated that DSS has not had a consistent history of success. Although there has been improvement in recent years, the general lack of success in realizing planned production cost savings confirms the need for greater management attention to product costs.

2.157 **Controls over computer support**. We noted a great deal of imbalance among the management control systems. Our review indicated that the basic mechanisms for controlling resources were adequate. However, the controls that serve as a mechanism for managing them were deficient.

2.158 **Spending on automation**. The Department's pattern of spending on the various components of information technology has remained static in recent years. The relatively low level of spending on new development of 7 per cent, if continued, will contribute to a decline in the quality of DSS systems.

2.159 **Role of management**. The elements of sound management of productivity and automation need to be fully developed and implemented if DSS is to improve productivity in its regional operations, obtain maximum value for its spending on automation and lower its product costs, while maintaining current product quality.

Financial Management and Control

2.160 Except for our concerns over a new computer system, we did not identify significant deficiencies in financial control systems within the scope of this audit. But, as discussed throughout the chapter, many of the tools required for sound financial management have been either inadequate or missing. We believe that this has been a major contributing factor to high product costs.

2.161 Financial accountability, another important tool of financial management, is provided to Parliament and central agencies through Part III of the Estimates and the Operational Plan Framework. We found, however, that the information provided fails to give a clear picture of the nature and costs of the services or products provided by DSS. We believe that Members of Parliament should be aware of the full costs of significant DSS products.

Conclusions and Recommendations

2.162 DSS has a productivity problem because the Department, while maintaining adequate product quality, has not given enough attention to product cost and has not fully exploited the benefits available from automation.

2.163 In recent years, DSS has reduced its overall person-year budget and implemented new policies and initiatives, all of which should contribute to lower product costs in the future. However, there remains a major challenge for management to improve productivity further while maintaining the current product quality.

CHAPTER 12 - DEPARTMENT OF NATIONAL HEALTH AND WEALTH

2.164 The Department of National Health and Welfare is responsible for matters relating to the promotion and preservation of the health, social security and social welfare of the people of Canada. It is one of the largest departments in the federal government in terms of expenditures, responsible for spending over 25 per cent of the government's annual budget. Over 95 per cent of total departmental expenditures for 1986-87 – $27 billion – is for statutory programs such as Old Age Security, Family Allowances and Health Insurance payments to the provinces. The remaining $900 million is for operating and other expenditures.

2.165 **Audit scope – our audit work focused on the management of the Department's major health programs.** The costs of these programs account for about 25 per cent of the Department's statutory programs – $7 billion – and over 70 per cent of its operating and other expenditures – $670 million.

2.166 **The Department was also included in the Financial Management and Control Study.** The results of that work, which was carried out throughout the whole Department, are reported in this chapter as well.

Health Programs

2.167 **In several areas we looked at, the Department has good systems and procedures in place.** For instance, the Health Services and Promotion Branch has well established procedures for managing projects funded under its $50 million grants and contributions and other programs. **There were other areas where improvement is needed, but the Department was taking appropriate action to address the situation.** For example, the Department has recently taken steps to improve productivity in the food and drug plant inspection process, including introducing robots and computerizing certain procedures in its food testing laboratories. There is room for further improvement, such as better use of inspection resources. But action is already under way to increase efficiency in this area.

2.168 There are, however, a number of areas where we have concerns, and they are being brought to the attention of Parliament. They have to do with certain aspects of the drug regulation process, the Indian and Northern Health Services activity, the administration of the Canada Health Act, and the Fitness Canada contribution program.

2.169 **Drug regulation.** The regulation of the drug industry is a federal responsibility under the Food and Drugs Act. Health and Welfare Canada must approve all new drug products for use in Canada, monitor their manufacture and sale and be aware of situations where these products may be causing ill effects on the public. We have particular concerns about the drug submission review process, the management of the emergency drug release program, and the monitoring of adverse drug reactions.

2.170 **There were significant delays in reviewing and approving drug submissions, and the backlog in clearing these submissions was increasing at an alarming rate.** In 1985-86, it was taking an average of over two years to approve a human prescription drug for marketing. This was six months longer than the year before. The backlog of these submissions has increased at an average annual rate of 35 per cent from 1981 to 1986 and by 69 per cent from 1985 to 1986 alone.

2.171 These delays have been recognized and pointed out by the 1985 Eastman Commission of Inquiry into the Pharmaceutical Industry and by the 1985 Ministerial Task Force on Program Review.

2.172 Over the past two years, the Department has undertaken a number of initiatives to try to deal with the situation. However, to date, these initiatives have not yet resolved the problem. The Department attributes this to limited resources and an increasing annual work load of 8 per cent.

2.173 We also believe that there is room to improve the management of the drug submission review process and handle submissions faster. This includes establishing productivity targets and completion dates, ensuring better quality and more complete submissions by drug manufacturers, assessing the adequacy of professional training programs, and considering alternative approaches such as computerizing some of the procedures.

2.174 **The Department has not established an adequate system for monitoring and reporting the results of the use of drug products released on an emergency basis.** The legislation provides that new drugs waiting for approval may be released for use on an emergency basis. This release is conditional on the physician reporting the results of the drug's use to both the manufacturer and the Department. The number of emergency drug releases authorized has increased significantly in recent years, from 1,204 in 1978-79 to 9,903 in 1985-86. This is due, in part, to the lengthy delays in approving new drug product submissions.

2.175 Only about 30 per cent of the releases authorized by the Department result in verbal or written feedback from physicians. Moreover, the results of this feedback are not systematically analysed or used in reviewing and approving the drug product for general release.

2.176 **The system for monitoring adverse drug reactions is inadequate – this means that some Canadians may be facing unnecessary risk.** There are no procedures to ensure that drug manufacturers are reporting all adverse drug reactions as required by legislation. Two different directorates in the Department collect information on adverse drug reactions, but the information is not consolidated or analysed in total and used to monitor drug safety. Also the system for filing and analysing data is primarily manual. This causes delays in compiling information. At the time of our audit, the Department had initiated action in several areas to improve the collection and utilization of this information.

2.177 **Indian and Northern Health Services.** The federal government, through the Department of National Health and Welfare, provides health services to status Indians and Inuit and to residents of the Yukon and Northwest Territories. In delivering these services, the Department operates 500 health facilities across Canada and employs over 3,000 health aides and professionals.

2.178 **We found that the health aides and professionals were well regarded by the population they serve.**

2.179 **However, despite external and internal recommendations to improve them, existing planning, evaluation and management information systems are so deficient that the Department cannot be sure that the delivery of health services to status Indian, Inuit and northern populations is adequate or whether it is delivering them with due regard for economy, efficiency and effectiveness.**

2.180 An illustration of this is the National Native Alcohol and Drug Abuse Program, a $50 million contribution program whose objective is to reduce alcohol and drug abuse in Indian and Inuit communities. It began as a pilot project in 1975 and became a permanent program in 1982. Although it is now 12 years old, we found that there were no performance measures for the program, and little information on drug and alcohol abuse in the communities was being collected, despite Treasury Board requests to do so. Financial management and controls over contribution agreements were weak, and three of the four implementation goals approved by Cabinet for the continued funding of the program had not been met. Efforts have been under way for the last 10 years to evaluate the program; no evaluations have been completed.

2.181 Some 40 per cent of the expenditures for the Indian and Northern Health Services are for non-insured health benefits. These are health-related goods and services, such as patient transportation, prescription drugs and dental services provided by the Department to status Indians and Inuit, that are not normally covered by provincial health insurance plans. These costs have escalated rapidly – from $36 million in 1979-80 to $166 million in 1986-87. Despite their significance, we found that there was little information on these benefits in Part III of the Estimates; some of the information that was there was misleading. Moreover, it appears that the Department may be paying as much as $40 million a year for health care costs that should be borne by the provinces and territories.

2.182 We also noted instances where new health care facilities are being built with excess capacity.

2.183 **Health Insurance.** The Department of National Health and Welfare is responsible for administering the Canada Health Act. Annual transfer payments of some $7 billion are made subject to provincial and territorial health insurance plans operating in accordance with the terms and conditions of the Canada Health Act.

2.184 We reviewed how the Department monitored compliance by the provinces and territories with the terms and conditions of the Act. **In some areas, monitoring procedures were satisfactory; in others, improvement was required.** For example, the Department does not have an up-to-date documented assessment of provincial legislation and practices that highlights areas of potential or actual non-compliance, what action has been taken and where things stand in the consultation process. There is no documented timetable for resolving these issues, and notices of concern have not been issued to the provinces, as required by the Act.

2.185 The Minister is required to report annually to Parliament on the extent to which the provinces and territories have complied with the Canada Health Act. **Two annual reports have been made to Parliament since the Act was introduced in 1984. Neither commented on compliance with the Act. As a result, it is difficult for Parliament to determine whether billions of dollars in annual transfer payments are being made in accordance with its direction.**

2.186 **Fitness Canada.** This is a directorate within the Department's Fitness and Amateur Sport Branch. It provides $8 million in annual contributions to national voluntary organizations, universities and arm's length entities such as PARTICIPaction.

2.187 **In our opinion, there is inadequate financial management and control over the administration of the Fitness Canada contribution program.** The planning and budgeting process requires improvement. There is little documented evidence that the financial viability of projects is adequately challenged before contributions are approved, and payments are being made in advance of need. Financial reporting requirements are not being enforced, and recent internal audit recommendations had not been fully addressed.

2.188 **The Department also needs to review the efficiency and effectiveness of the Fitness Canada program.** There has been no departmental evaluation of the program's operations for over 10 years. Also, there were no formal procedures for monitoring and evaluating projects in accordance with Treasury Board requirements. Many of the organizations Fitness Canada supports have depended on the federal government for many years for all or most of their funds. One of the criteria for funding ongoing projects is the expectation that they will become self-sufficient. Yet we saw no evidence to indicate that this is ever formally considered in renewing contribution funds. As well, given that the current climate of fiscal restraint and given that the program is now 25 years old, the Department needs to reassess the proportion of funding directed to administrative support, which we estimate to be 65 per cent of total contributions. Finally, the Department should ensure that financial considerations are taken fully into account when making major decisions affecting program delivery, particularly as they relate to arm's length entities.

Financial Management and Control

2.189 In the Department of National Health and Welfare, we found that financial controls, with some exceptions, were generally satisfactory and had improved since the 1974-76 study. This is important because over 95 per cent of the Department's expenditures is for statutory programs.

2.190 However, in the operating and other programs, the necessary cost information for decision making is not always provided. Moreover, as is noted in Chapter 12, there is a lack of adequate planning, information and evaluation in many areas. This is preventing effective financial management. Managers cannot always be sure they are delivering programs with due regard to economy, efficiency and effectiveness.

2.191 The Department has responded to the needs of Parliament and Treasury Board for information through the Operational Plan Framework, Multi-year Operational Plans and Part III of the Estimates. But there are weaknesses in all these documents. Resources are not adequately linked to results, there has been little in the way of progress reporting on new initiatives, and there is inadequate disclosure of certain program costs. Moreover, we saw no evidence that these documents are being used, internally or externally, to demonstrate financial accountability.

CHAPTER 13 - DEPARTMENT OF TRANSPORT

2.192 Transport Canada makes large capital investments each year. Annual capital expenditures for airports, air and marine navigation equipment, ships and wharves are $642 million for the 1986-87 fiscal year. These capital acquisitions have an additional impact: the costs of operating and maintaining these assets will increase future years' operating expenditures.

2.193 Past audits commented on the lack of financial advice and analysis relating to major operating and capital investment decisions in both the Air and Marine programs. We found that the Department has significantly improved the quality of its systems for allocating new resources and of the financial advice and analysis related to capital expenditures.

2.194 **Improved advice and analysis.** The creation of a Program Control Board and the implementation of a major deficit reduction plan in the Department have provided a framework for critical review of proposed capital projects for allocating resources. One of the results has been a more intensive financial challenge of major projects before they go forward for Treasury Board approval. Although improved, this review is still hampered by a lack of cost information, performance indicators and defined levels of service.

2.195 **Problems with asset management.** Financial input into current revenue and expenditure decisions has not been as effective as for capital projects. There has been some progress in implementing common business practices in areas where the operating environment requires them, such as cost recovery initiatives. However, systems for managing accounts receivable, inventories and real property have had serious and, until recently, persistent weaknesses. In the past, revenue recoveries have been hampered by inadequate practices in granting credit and in collecting accounts. The Department has taken steps to improve collections, but states that constraints imposed by government-wide directives limit its options for innovation in quasi-commercial operating environments. Management of inventories has suffered from a lack of information, both centrally and regionally, that would allow managers to control inventory levels and avoid a build-up of obsolete or duplicate stock. Information on real property, consisting primarily of land and buildings, was also inadequate; corporate decision makers lack information, such as the holding costs of land, needed for decisions on property use and disposal. There are initiatives under way to deal with most of these problems.

2.196 **Improved internal accounting controls.** Although deficiencies in the financial input to current operating decisions continue, we found that there have been improvements in internal accounting controls. Better segregation of duties, and other changes, have provided improved control over routine revenue and expenditure transactions. We still have concerns, however, regarding the control of non-routine complex transactions between the Department and Crown corporations and within the Airports Revolving Fund.

2.197 **Serious problems with financial information systems.** We found serious deficiencies in planning and implementing major corporate financial information systems. The systems do not provide financial information the Department has consistently identified as being important. Lack of this information, including asset and operating cost information, has inhibited improvements in the control of current operating costs and has hampered cost recovery initiatives.

2.198 **Subsidies to achieve national objectives.** Parliament authorizes a wide variety of federal subsidies to commercial carriers, or to users of transportation services, to achieve certain national transportation objectives. In the case of one of these, the At and East subsidy program, we found that the program has had results that differ from those contemplated when the legislation was passed.

2.199 For example, subsidy payments have encouraged Canadian exporters of grains and flour through eastern ports to choose routes in Canada that represent an inefficient use of transportation resources. An evaluation study made by Transport Canada and the Canadian Transport Commission disclosed that the subsidy had resulted in a number of unintended effects that were contrary to the National Transportation Act objectives of "making the best use of all available modes of transportation at the lowest total cost". However, they did not analyse program alternatives that would diminish the inefficiencies. We also found that there were deficiencies in verifying payments for the subsidy.

2.200 Control over eligibility of commodities for the Maritime Freight Rates Act and the Atlantic Region Freight Assistance Act subsidy programs was weak, resulting in approving applicants without first ascertaining the costs of providing the subsidy to other companies that automatically become eligible for subsidy once the application has been approved. There was also no routine review of commodities to determine whether they were still eligible for subsidies.

2.201 **General overall improvement in some areas of financial management and control.** In summary, we concluded that there has been an overall improvement in certain aspects of financial management and control in the Department, particularly in the last two years. The systems for allocating resources and providing financial advice and analysis on new initiatives have improved significantly. However, problems with financial input into current operating decisions persist. These need to be addressed if the general momentum toward sound financial management is to be maintained.

CHAPTER 14 - EMPLOYMENT AND IMMIGRATION CANADA

2.202 The Canada Employment and Immigration Commission/Department is responsible for employment, unemployment insurance and immigration programs and related policy planning and development. Our audit this year examined one part of the Employment and Insurance program, the Canadian Jobs Strategy. In 1986-87, the Strategy spent about $1.5 billion and had about 400,000 participants. In addition, as part of the financial management and control study reported in Chapter 4, we examined financial management and control systems.

2.203 First announced at the First Ministers' Conference in February 1985, the Canadian Jobs Strategy replaced former training and employment development programs in the form of an integrated strategy. The Strategy was made up of a series of programs to focus on clients most in need or address a specific labour market problem. The new approach was to be easier to understand by being more streamlined and simplified.

2.204 **No formal financial analyses were carried out of the alternative approaches when the Strategy was developed.** An announcement was made in February 1985 of an additional $900 million in new funds for training and employment programs in 1985-86. There were no formal financial analyses of alternatives to the selected programs and options or alternatives to how they were combined in the Strategy. To ensure that expenditures will be made with due regard to economy, formal financial analyses of new initiatives are required.

2.205 **The Canadian Jobs Strategy was put into operation in a short time.** As early as December 1984, Employment and Immigration Canada had started a series of wide-ranging consultations on the concepts behind the Strategy. Since terms and conditions for five of the six programs were not approved until mid-June 1985, only two and a half months were left to finalize the programs and the detailed work tools for implementation on 5 September 1985. The details of the sixth program were to be announced in the fall.

2.206 **There were problems with the availability of new tools at the program launch.** Some new operational tools such as forms, guidelines and brochures were not available at the time the program was launched; these were needed to provide required support to staff responsible for implementing far reaching changes in programs. The greatest difficulty was experienced with the Job Development program which accounted for the largest Strategy expenditure. Given the experience with earlier programs, personnel responsible for program delivery were able to turn to the work instruments and procedures that were in place before the Strategy.

2.207 **A number of Job Development contribution agreement files were incomplete.** In our audit of contribution agreements initiated in 1985-86 under the Strategy, we noted that while the majority of the files were complete, 40 per cent, mainly in Job Development files, did not contain all the information necessary for a complete analysis at the time the proposals were selected. Thus, Employment and Immigration Canada cannot give assurance that all Job Development proposals were selected and approved in accordance with program objectives. In addition, the authority for determining and monitoring eligibility of participants in this program was not clearly defined when outside organizations were involved.

2.208 **Difficulties in the start-up of the Strategy combined with Treasury Board freezes resulted in a lapse of 20 per cent of program funds.** Of the total 1985-86 appropriation of $1.8 billion, $141.5 million was spent on new Canadian Jobs Strategy programs and $1.29 billion was spent on former programs. A total of $357 million was lapsed for employment and training programs – approximately $228 million because of Treasury Board freezes, and $129 million because of difficulties in the start-up of the Strategy programs.

2.209 **Ongoing adjustment to streamline and simplify the delivery of the Canadian Jobs Strategy programs are taking place.** An internal task force recommended a number of improvements in program delivery, work instruments and management information systems. Implementation of the recommendations is expected to start 1 April 1988 with completion dates still to be determined for a number of the changes.

2.210 **Training in institutions was integrated into the Strategy in its second year.** Approximately 42 per cent of Strategy expenditure in 1986-87 was for purchasing training in institutions. Regions had difficulties in interpreting how the new indirect purchases or commitments would be defined or monitored. Only one federal-provincial territorial agreement had been signed as of 1 April 1986. Ten were signed during 1986-87 and one had still not been signed by 1 July 1987.

2.211 **Some of the targets set to ensure fair access to Strategy programming were in the short term unrealistically high.** Interim participant targets for designated groups in the Strategy had been set in 1985-86; they stayed essentially unchanged. Although some targets were achieved or surpassed, program staff had difficulties in attaining some of the targets, particularly for the options where eligible participants were already employed or in apprenticeship training. These have traditionally low target group participation for programs to draw upon.

2.212 **Measurement of program results for two of the main options of Job Development will not be available until December 1987.** To determine how well the Strategy is working, participants are surveyed 3 and 12 months after they have left the program. The three month survey provides a sound mechanism for measuring short-term program effectiveness. There have, however, been some problems with the implementation of the survey. These problems were being corrected at the time of our audit.

2.213 **The vote wording does not accurately reflect the Canadian Jobs Strategy activity.** While the vote wording refers to providing employment to unemployed workers, five of the six Strategy programs do not have an objective of direct job creation and at least three of the six programs are not restricted to unemployed workers. Vote wording is determined in consultation between Employment and Immigration Canada and Treasury Board.

2.214 **Information to Parliament on the Canadian Jobs Strategy as a new initiative was not sufficiently detailed in Part III of the Estimates.** The narrative of the Part III comprehensively describes the Canadian Jobs Strategy. However, the information on number of participants and expenditures does not distinguish between former employment programs and new Strategy programs; for example, readers cannot determine that $141.5 million had been spent on new program activity out of a total expenditure of $1.4 billion.

2.215 **The Operational Plan Framework is a good reflection of the way the operations are managed although certain areas for improvement have been identified.** Employment and Immigration Canada's Operational Plan Framework has been approved by Treasury Board, with some reservations about the performance indicators established for National Employment Services. The statements of objectives for the Employment and Insurance Program as well as two of its activities are too broad. They are not sufficiently precise to serve as a basis for allocating resources, measuring performance or ensuring accountability. However, in the case of the Human Resource Development activity (of which the Canadian Jobs Strategy is a part), Employment and Immigration Canada has established links between the objectives and the expected results.

2.216 **Budget allocations are based on priorities and operational targets as well as on historical considerations.** Employment and Immigration Canada allocates funds in the Unemployment Insurance program in line with identified priorities and operational targets, which then serve as performance indicators. For the Canadian Jobs Strategy, the main consideration in the allocation of funds to the regions is the stability of funding levels compared to past years. Person-years are determined on the basis of each program's relative share of funding in the previous year. In both cases periodic variance analyses are carried out, comparing actual to planned results, and these are used as the basis for management decisions.

2.217 **Our audits of the last years have indicated no significant shortcomings in the internal financial control systems.** However, a reservation of opinion on the financial statements of the Unemployment Insurance Account for the year ended 31 December 1985 was expressed. This matter has now been resolved by Employment and Immigration Canada.

2.218 **The Employment and Immigration Information System integrates financial, operational and personnel data.** Managers are generally satisfied with the accuracy and reliability of the information produced by the corporate management information system. It is used to monitor and report on Employment and Immigration Canada's operations. However, there is a problem with timeliness in the transmission of information, particularly at district and local levels. Employment and Immigration Canada has set up pilot projects to correct these shortcomings.

2.219 **Employment and Immigration Canada's Financial Services plays an important role in financial management.** It provides management with information through an integrated management information system and reviews the preparation of budgets and forecasts. Financial Services, with the Strategic Policy and Planning Group, is responsible for the functioning of the Planning and Accountability Process and the conduct of quarterly analyses of operational and financial results.

2.220 **Since 1975, significant progress has been achieved in financial administration structure and processes.** Our audits have shown that Employment and Immigration Canada has in place an internal control section, a planning and accountability process and an integrated management information system.

CHAPTER 15 - SPECIAL AUDITS

2.221 Special audits examine specific programs or activities within a department or across several departments that would not be audited on a regular basis. This year's chapter contains reports on:

- reporting to Parliament of losses due to fraud and other illegal activity against the Government of Canada;
- risk management audits;
- four major capital projects;
- emergency preparedness by national emergency agencies; and
- the use of microcomputers in departments and agencies.

Reporting Losses Due to Fraud and Illegal Activity

2.222 In 1983 Parliament amended the Financial Administration Act (FAA) to empower the government to make regulations prescribing actions to be taken in "respect of losses of money or public property, however caused, suffered by Her Majesty."

2.223 In 1985 we advised the President of the Treasury Board that certain deficiencies existed in the implementation of the amendment. On 20 February 1987, the Treasury Board issued a policy covering the reporting of all losses, including those resulting from illegal activity. The policies address most of the matters we raised with the President of Treasury Board regarding losses of money. But the policies do not apply to Crown corporations and do not cover losses of public property.

2.224 The Administration Policy Branch of the Treasury Board Secretariat has advised us that it plans to issue further policies and directives covering losses of public property due to fraud and other illegal activity by November 1987.

2.225 The Crown Corporations Directorate of the Department of Finance and Treasury Board has advised us that it proposed that the President of the Treasury Board write to ministers responsible for Crown corporations requesting that they ask Crown corporations to ensure that material losses of money and property are brought to the attention of management and the RCMP in a timely manner.

2.226 We have recommended that an annual consolidated report to Parliament on losses due to fraud and illegal activity in Crown corporations should be made. The Directorate believes that it is sufficient that avenues exist for such losses to be brought to light through requests by parliamentary committees and annual audits and special examinations.

Risk Management Audits

2.227 In 1986 we strengthened our risk management audit procedures. The procedures are designed to assess the adequacy of the measures taken by departments and agencies to minimize the risk of losses.

2.228 We focused our attention on selected major capital projects and found deficiencies in two areas, one dealing with Navaid Tender/Light Icebreakers and the other with DSS's verification of information about education and experience in contracts where the qualifications of individuals are an important factor. Our detailed findings are set out in Chapter 15.

Capital Projects

2.229 We examined 12 projects with combined projected costs approached $1.2 billion. Chapter 15 contains the results of our audits of four of these projects.

2.230 In one case we found that the Department of Supply and Services had not overseen the contract for the construction of a ship in an effective manner. We also found that the Coast Guard had not defined levels of service or completed life cycle costing for the ship program in question.

2.231 Another case dealt with two facilities built by the National Research Council at an estimated cost of $98.2 million. One program was cancelled and, until recently, the building was empty, at an annual cost of $3.8 million. In our view, with which NRC agrees, the need for the service provided by the second facility could have been met by increasing the capability of an existing facility – a saving of $30 million.

2.232 Our investigation of the Lake Louise Development project revealed that Parks Canada had not considered life cycle costs in determining areas for development. We also found deficiencies in project management and project evaluation. Further, Parks Canada built on land that was granted, under certain conditions, to the Canadian Pacific Railways and where the present ownership of the land is not clear. We also found a lack of control over private sector development.

2.233 We also examined the Olympic Park being prepared for the 1988 Winter Olympics. We found that this project was well managed.

Emergency Preparedness

2.234 Our audit looked at federal planning and preparations for national emergencies by National Emergency Agencies. We found that responsibility for the overall planning system was not clearly defined, and co-ordination among the agencies was inadequate. We also found it difficult to assess the progress made toward the development of plans for the National Emergency Agencies because the goals and deadlines had not been established.

2.235 Legislation has recently been tabled that concerns some of the issues we identified in this audit.

Microcomputers

2.236 Given the major influx of microcomputers into government, we examined how well this new technology was being managed in several departments.

2.237 We found that the introduction of microcomputers has generally had a positive effect. We observed numerous cases where the microcomputer has offered a relatively simple means of improving the efficiency and effectiveness of operations.

2.238 However, we also found that the introduction of microcomputer technology is not yet sufficiently well planned and controlled to ensure that the full potential of this important tool is realized.

2.239 Managers are generally not measuring the effects on productivity of the use of microcomputers. Microcomputers are acquired primarily in response to individual staff requests, not as part of any overall plan for the development of computing in departments. There is a need to improve training, support and guidance for microcomputer users. Also, departments have to pay more attention to security and control of data on microcomputers.

CHAPTER 17 - MANAGEMENT CATEGORY

2.240 **Background.** The management of senior personnel in the public service has been the subject of a number of reports and studies over the past 25 years. Among others, the Glassco Royal Commission on Government Organization (1962), the Finkelman Report on Employer-Employee Relations in the Public Service of Canada (1974), the Lambert Royal Commission on Financial Management and Accountability (1979) and the D'Avignon Special Committee on Personnel Management and the Merit Principle (1979) expressed a number of concerns including:

- the lack of a sufficient and identifiable managerial cadre,
- the need for deputy heads to have more authority and flexibility in managing their senior human resources in a manner that permits accounting for the use of that authority; and
- the lack of attention given to human resource management and the lack of appropriate human resource policies for senior personnel.

2.241 In response to these and other concerns, the President of the Treasury Board announced plans in July 1980 to establish a Management Category as the foundation for improving management in the public service. Specific objectives were established that were communicated to all prospective members of the Category.

2.242 The creation and management of the Management Category took place in an environment characterized by budgetary restraint and increased government control over the size of the public service.

2.243 The Management Category now accounts for about two per cent of the public service population. In 1986 it represented salary expenditures of more than $288 million.

2.244 **Audit scope**. Our audit included reviewing key human resource management policies, systems and practices in areas such as job evaluation, compensation, resourcing and related practices (human resource planning, staffing, training, career development and counselling), and performance management. We also assessed the progress made toward achieving the objectives envisaged by the government when it established the Management Category. We carried out audit work in Treasury Board Secretariat, the Public Service Commission and in six departments. A survey questionnaire was sent to all members of the Category. It corroborated our audit findings.

2.245 **Observations.** The creation of the Management Category has resulted in the grouping of about 4,300 Executives and Senior Management under a common system of job evaluation, thereby providing a common and uniform approach to compensation. In addition, deputy heads have increased authority and flexibility to utilize and deploy Management Category personnel, and mandatory orientation training programs have been established.

2.246 The lack of a clear and consistent definition of "management personnel" and significant differences in the nature of the responsibilities, perceptions and attitudes of members of the Management Category work against the concept of an identifiable and cohesive managerial cadre. Because the Management Category does not include all of the senior management team necessary to manage departments and governments programs, deputy heads' flexibility is restricted. Also many of the policies and programs predicated on some similarities among positions at each level are less effective than expected. Finally, the degree to which the Management Category is a departmental and/or a service-wide resource is not clear.

General Summary

2.247 The management and operation of the Management Category Position Evaluation Plan, the current system for determining the relative value and classification level of Management Category positions, have not been carried out in a manner that provides for internal relativity between Management Category positions. There is little assurance of consistency of classification decisions within and among departments. Since job evaluation results form the basis for compensation comparisons with other sectors of the economy, these inconsistencies impede reliable compensation comparisons. Treasury Board Secretariat has not devoted sufficient resources to the Management Category job evaluation function. Current job evaluation practices do not allow for the delegation of Management Category classification authority, as planned.

2.248 Current compensation practices do not support the attainment of internal compensation relativity between the Management Category and other occupational groups. There is no definition or agreement on what might constitute acceptable compensation practices in the public service. Because the methodology used as a basis for determining compensation comparability for the Management Category differs from that used for bargaining groups, there is no common basis to compare compensation. In a number of cases, members of the Management Category have subordinates who have access to higher salary rates or whose salary ranges severely overlap theirs.

2.249 There has been considerable effort invested in performance management practices for the Management Category, and members of the Category were satisfied with the performance appraisal process. The lack of a clear relationship between performance rating and pay for performance is a major source of dissatisfaction among Management Category members. The lack of a continual provision of pay for performance over the years, coupled with concerns about the inequity in its application, has reduced its effectiveness.

2.250 Although departments are making efforts to identify and address the problem of inadequate performance, some of the current practices may lead to a tendency, in some cases, to transfer the responsibility for handling performance problems to other managers or to agencies such as the Public Service Commission.

2.251 The current approach to Management Category staffing provides deputy heads with increased authority to deploy Executives and Senior Management. However, a number of policies, systems and practices announced are not in place or have not evolved as originally intended. This has resulted in a lack of a clear understanding of how Management Category appointments are made, a desire for more information on appointments, particularly those made at the departmental level, and a desire on the part of members to have more information on opportunities for advancement at the departmental and the service-wide level.

2.252 The legislative and administrative framework for the Management Category does not ensure that roles and responsibilities for the management of this key resource are clearly defined and delineated, that authority is consistent with responsibilities, and that adequate review mechanisms are in place. Accountability is therefore weakened. In addition, the lack of visible leadership, a focal point and a forum for resolving problems makes it difficult to have an integrated and co-ordinated approach to managing the Management Category and the related human resource policies and programs.

2.253 While there has been some progress, many of the announced changes have not occurred. This has contributed to cynicism and disillusionment and brings into question the degree of commitment of the government and the central agencies to achieving the stated objectives.

2.254 Many Management Category members think that some of the current programs or practices are inadequate or in need of review. They are also of the opinion that departmental performance should influence the extent to which delegated authority should be granted to deputy heads for the management of the departmental managerial cadre. We share those views.

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AUDIT NOTES

Introduction

3.1 This chapter contains matters of significance that we believe should be drawn to the attention of the House of Commons. They have not been reported elsewhere in the Report, but have come to our attention during our audits of the Accounts of Canada, Crown corporations and other entities.

3.2 Section 7(2) of the Auditor General Act requires the Auditor General to call Parliament's attention to any significant cases where he has observed that:

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

3.3 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards, and accordingly our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department, Crown corporation or other entity heading.

3.4 This year our report under section 11 of the Auditor General Act on the Oil Pricing Compensation Programs is not included in the annual Report. The programs were eliminated effective 1 June 1985 and during the fiscal year 1986-87 transactions totalled less than $10 million in revenue and $7 million in expenditures. As usual our audit report will be transmitted under separate cover to the Governor in Council.

Observations on Crown Corporations

3.5 The Auditor General is appointed auditor of 44 Crown corporations, under the Financial Administration Act or individual Acts incorporating specific corporations. Details of significant reservations and other matters contained in reports issued to these corporations during the year are set out below. Most of these matters have already been raised in a public forum, but they are reported here for emphasis and for consideration by Parliament.

3.6 Canadian Broadcasting Corporation - Successful recovery program led to revision to the 31 March 1986 auditor's report

> During 1985-86, a number of serious difficulties were experienced in implementing phase one of the National Finance System (NFS) and in maintaining proper books of account during the transition period. In our 1986 annual Report, we commented on these problems and recommended to the Corporation that, because public funds were at risk and several months had elapsed into the current fiscal year, these problems should be corrected immediately.

3.7 In August 1986, the Corporation announced the establishment of a senior level Task Force to develop an action plan to examine and address these critical matters. In November 1986, the Task Force recommended an action plan which was adopted by the Corporation. During the year ended 31 March 1987, the Corporation took steps to overcome the effects of the implementation and design problems of the initial phase of the NFS. As a result, the Corporation succeeded in stabilizing the existing components of the NFS, in restating its financial statements for the year ended 31 March 1986, and in re-establishing proper books of account by 31 March 1987.

3.8 In our 1987 report to the Canadian Broadcasting Corporation and the Minister of Communications, we revised the auditor's report for the year ended 31 March 1986 to state that except for the effect of adjustments, if any, regarding the classification of expense amounts on the restated Statement of Income and Expense and Reconciliation to Government Funding Basis, the restated financial statements present fairly the financial position of the Corporation as at 31 March 1986. And we rendered an unqualified audit opinion on the 1987 financial statements.

3.9 National Museums of Canada - Overexpended appropriation, Department of Communications - Vote 70

> For the fiscal year ended 31 March 1987, the Corporation's operating expenditures exceeded the parliamentary appropriation by $1,373,000. This situation is mainly attributable to the acquisition of all the assets from the Canada Pavilion at Expo 86 for use in the fit-up of its new museums facilities. These items, which, according to management, have an estimated market value of $4 million, were purchased at a cost of $2 million under a contractual agreement signed in August 1986.

3.10 In August 1986, the National Museums of Canada entered into an agreement with another Crown corporation, to purchase the assets of the Canada Pavilion at Expo 86 for an all-inclusive price of $2 million. These assets, valued at $4 million by management, consisted mainly of audio-visual equipment, display materials and office furniture and equipment for use in fitting up its new museum facilities. This transaction was the main reason why the Corporation's operating expenditures exceeded its parliamentary appropriation by $1,373,000.

3.11 Our audit report on the financial statements of the National Museums of Canada for the year ended 31 March 1987 disclosed that the Corporation exceeded its parliamentary appropriation for operations. This is contrary to the provisions of the Financial Administration Act.

Observations on Departmental Operations

3.12 Department of Agriculture - Lack of compliance with authorities by the Agricultural Products Board

> The Agricultural Products Board is delivering a program through administrative arrangements that do not comply with the Financial Administration Act and the Agricultural Products Board Act. For this reason, we expressed an adverse opinion on the Board's compliance with authorities in connection with our examination of the Board's financial statements for the year ended 31 March 1987.

3.13 The Board purchases and sells various agriculture commodities in order to stabilize their prices. In doing so, the Board may incur losses that are financed by moneys appropriated by Parliament. For the past three years, approximately 77 per cent of the Board's losses have resulted from the purchase and resale of Ontario grapes and grape products. Losses on these products have amounted to $11.2 million over three years, after $5.5 million contributed by the Province of Ontario.

3.14 As part of the Surplus 1986 Ontario Grapes Program, the Board entered into administrative arrangements that, in our opinion, were not in accordance with section 5 of the Agricultural Products Board Act. A bank account was established outside the Consolidated Revenue Fund. This account has been administered in trust by an agent and all public moneys associated with the Board's Surplus 1986 Grape Program have been deposited and disbursed through this account. The Board is not authorized to operate a program in this manner. As a result, $1 million of public moneys from the sale of grape products was not deposited to the Consolidated Revenue Fund, and program expenditures were not all paid from moneys appropriated by Parliament as required by the Board's Act. The use of these revenues to pay Board expenditures is not within the Board's authority. This was undertaken because of a budget shortfall originally estimated at $1.1 million.

3.15 In addition, the Board has incurred losses to 31 March 1987 of $2.8 million in excess of the maximum amount authorized by Governor in Council in respect of the Surplus 1984 Ontario Grapes Program. At the time of our audit, the Board had yet to obtain approval for this additional loss. Subsequently, authority was received for additional losses, bringing the total authorized loss to $5.85 million.

3.16 Department of Agriculture - Appropriation exceeded

> Parliamentary appropriation to Agriculture Canada in respect of the Canadian Forestry Service Program for the fiscal year ended 31 March 1987 was, in substance, exceeded by $2.9 million. This resulted from a lack of financial control over certain contribution expenditures of the Canadian Forestry Service.

3.17 As of 30 November 1986, expenditures of up to $17.6 million had been committed by the Forestry Service for payments under the Canada Ontario Forest Resource Development Agreement. Although this exceeded the authorized budget for 1986-87 by $6.1 million, management anticipated that all of the $17.6 million would likely not be spent by March 1987. Therefore, no forecast was prepared to determine whether funds would be available within Vote 30. Section 25(1) of the Financial Administration Act requires the Department to ensure that unencumbered funds are available for all expenditures.

3.18 Vote 30 has been reported to Parliament as having been exceeded by $1.3 million. However, this amount does not include unrecorded claims of $1.6 million applicable to the 1986-87 fiscal year, but which were received after the processing date. In our view, the parliamentary appropriation has, in substance, been exceeded by a total of $2.9 million.

3.19 Department of Agriculture - Failure to deposit public moneys in the Consolidated Revenue Fund and unauthorized use of public moneys

> The Forest Pest Management Institute of the Canadian Forestry Service has conducted research with the financial support of private sector chemical companies. The Institute arranged to have funds sent from these chemical companies to personnel service agencies, which administered the funds as directed by the Institute. This bypassed normal financial controls and the authority of Parliament, since what should have been public moneys were not deposited to the Consolidated Revenue Fund as required by the Financial Administration Act. Additional amounts were properly deposited but were used for purposes not specifically authorized.

3.20 Since 1981, chemical companies have paid a total of $738,198 for the cost of the Institute's testing of forest pest control products that were being developed by the chemical companies. The Institute arranged for the payment in two ways: a total of $437,765 was paid to personnel service agencies, and $300,433 was deposited direct to the Consolidated Revenue Fund.

3.21 Amounts sent by the chemical companies direct to personnel service agencies were subsequently spent by the agencies as directed by the Institute. In our view, these were public moneys which should have been deposited in the Consolidated Revenue Fund in accordance with the requirements of the Financial Administration Act. The money received by the personnel service agencies from the chemical companies was used to pay for staff salaries and other research costs incurred by the Institute. In normal circumstances, such costs would be charged to the Institute's budget. The agencies were compensated for their administrative services from the funds held by them.

3.22 Amounts received by the Institute were deposited in the Consolidated Revenue Fund to the credit of a specified purpose account. This provided additional funds to pay for Forestry Service operating costs, thus supplementing the operating budgets.

3.23 The Internal Audit Division of the Department of Agriculture reported that no authority or policy could be found for the use of external funding of research conducted by the Institute. Management responded by terminating the use of personnel service agencies. All moneys provided by chemical companies are now deposited in the Consolidated Revenue Fund. The Department is now taking steps to obtain the appropriate authorities.

3.24 Department of Communications - Inadequate control over contribution payment

> On 23 February 1987, the Department of Communications approved a payment of $250,500 as part of a renovation and expansion project for a cultural centre. At the time the payment was approved, the Department was aware that the project differed substantially from what had been approved.

3.25 In March 1985, the Department of Communications obtained Treasury Board approval under the Special Program of Cultural Initiatives to make a contribution of $870,000 to pay 50 per cent of the cost of a $1,740,000 project to renovate and expand the centre's facilities. The largest single component of the project was the construction of a fine arts school which was to comprise 40 per cent or $704,000 of the total estimated project costs. On 3 February 1987, as the result of a site visit, the Department became aware that the expenditures on the project were estimated to reach the full amount, without construction of the school.

3.26 All the funds had been spent on items such as theatre equipment, offices and general building renovations. Although it was aware that the expenditures by the centre on the project differed substantially from what had been approved, the Department paid the full amount of the contribution less the standard 10 per cent holdback. In our view, when it became aware that there had not been any expenditures for construction of the school, the Department should have reduced its assistance by $352,000 or 50 per cent of the estimated costs of the school, or else sought specific approval to proceed with a substantially different project, prior to making the payment of $250,500.

3.27 Canada Employment and Immigration Commission - Overcharge in the government's share of the cost of paying benefits - Unemployment Insurance Account

> The methods used to administer claimants' records of employment by Employment and Immigration Canada resulted, for a number of years, in an overcharge to the government for its share of the cost of paying benefits and in a corresponding understatement of the share funded by employer and employee premiums. As a result, the cumulative deficit in the Unemployment Insurance Account was understated for those years.

3.28 Our opinion on the financial statements of the Unemployment Insurance Account for the year ended 31 December 1985 was qualified because we were unable to satisfy ourselves as to the validity of the amount of overcharge in the government's share of the cost of paying benefits. It should be noted that the total benefits paid to claimants are not affected.

3.29 This situation has arisen because the methods used to determine benefits entitlement did not include a procedure to verify all records of employment for the qualifying period. This resulted in benefits being paid from the Regionally Extended Benefits Phase of the Unemployment Insurance program that is fully funded by the federal government, rather than from the other two phases that are funded by the employers and the employees.

3.30 In 1987, the Commission estimated the amount overcharged to the Crown at $73 million for 1985 and $70 million for 1986. The estimate for prior years is unavailable because of the cost and difficulty of obtaining the necessary information. The Crown has been reimbursed from the Unemployment Insurance Account for the 1985 and 1986 overcharges, and the financial statements of the Unemployment Insurance Account have been restated accordingly.

3.31 Subsequent to our audit the Commission took steps to correct this situation in 1987. It has issued a revised application form for Unemployment Insurance benefits requesting applicants to submit all records of employment dealing with their qualifying period. In addition, the Commission is taking measures to ensure that the records of employment filed with it are easily accessible so that it can ensure that a claim has been properly and accurately established. This should enable the Commission to determine accurately the cost of benefits to be charged to the Crown. However, close monitoring will be required to ensure that no overcharge to the government's cost of paying benefits exists for 1987 and future years.

3.32 Department of the Environment - Failure to provide Treasury Board with complete and accurate information

> In 1983 Parks Canada requested Treasury Board to approve certain lease amendments in two national parks. This, the Department stated, would result in foregone revenue in excess of $2 million over the remainder of the decade. However, the Department had determined that a low estimate of the foregone revenue would be approximately $11 million and an estimate capable of withstanding scrutiny would be approximately $17 million. Furthermore, when

Treasury Board questioned the $2 million, Parks Canada provided the Board with an estimate of $4.3 million. The decision to amend the leases was therefore made without complete and accurate information.

3.33 The Crown owns substantially all the land within the boundaries of the national parks. Within the parks, there are seven townsites; the two largest are Banff and Jasper. Land in these townsites is leased primarily to two groups of users - residential and commercial.

3.34 For the commercial users, the National Parks Lease and License of Occupation Regulations contain various methods of determining lease payments. In 1982, two methods predominated - one based on gross revenues and the other based on appraised land values. From the early 1970s to 1982, all new leases had their rents set using the percentage of gross revenues, which Parks Canada believed to be more consistent with practices followed in the private sector outside national parks.

3.35 In 1982, many hotels with lease payments based on gross revenues were making substantially higher lease payments than similar hotels with lease payments based on appraised land values. The owners of one particular hotel believed that they were being treated unfairly and requested that the government allow them to change the basis of payment.

3.36 In 1983, Parks Canada undertook a study to determine whether or not inequities existed and to initiate appropriate corrective action. The study identified significant inequities and, in July 1983, Treasury Board was asked to approve amendments to the leases to change the basis of the lease payments to the appraised land value method. Parks Canada advised Treasury Board that the downward adjustment of rents caused by this change would mean that the Crown would forgo in excess of $2 million of anticipated revenue over the remainder of the decade. In October 1983, Treasury Board approved the request and the amending regulations were approved shortly thereafter.

3.37 For a number of reasons, the $2 million figure was much lower than the amount identified by Parks Canada. For example, it had been based on 1981 revenues from room rentals alone (that is, excluding revenues from food, beverages, etc.) and provided no allowance for increases due to inflation or real economic growth. In addition, the list of hotels used in the analysis excluded three properties, all of which are now paying a significantly lower rent. In one case, the rent was reduced from a guaranteed minimum of $90,000 per year (as established by tender in 1980) to an average of approximately $17,000 per year. An internal departmental memorandum indicates that Parks Canada had determined that, when some of those factors were taken into account, a low estimate would be $11 million, and an estimate capable of withstanding scrutiny would be in the neighborhood of $17 million.

3.38 Treasury Board questioned the $2 million figure and, in response, Parks Canada prepared an analysis showing the foregone revenue to be approximately $4.3 million. Although higher, this figure contained many of the same deficiencies as the $2 million figure.

3.39 The working papers supporting the $11 million and the $17 million have been misplaced by the Department. We have been informed, though, that they were detailed and that certain key inflation and economic growth parameters incorporated in them had been derived from discussions with Treasury Board personnel. Our own calculations indicate that an amount of $11 million can be supported using the conservative estimates of inflation and real economic growth contained in other departmental working papers.

3.40 Department of the Environment - Failure to comply with Cabinet directions, and poor control over expenditure

In April 1986 Cabinet approved the Department's proposal for increased funding for Environment Week 1986. We found that the Department did not implement the advertising campaign that had been approved and did not seek Treasury Board approval until after the expenditure had been incurred. In addition, the Department did not have sufficient information to ensure that the advertising firm complied with the terms of its contract, resulting in a potential overpayment by the Department.

3.41 In 1985-86, the Department of the Environment proposed to Cabinet that funds for Environment Week 1986, an annual event sponsored by the Department to highlight environmental concerns, be increased from a budgeted $35,000 to $1 million in order that it could become a major public event.

3.42 In reviewing the Environment Week expenditures we noted the following:

3.43 **Project authorization and implementation.** On 16 April 1986, just six weeks prior to Environment Week, Cabinet approved the Department's proposal. Cabinet authorized $650,000 for advertising – $550,000 for media placements and $100,000 for fees to the Department of Supply and Services and/or an advertising agency. A further $350,000 was budgeted for administering, producing and evaluating the event.

3.44 Rather than implement the advertising campaign that had been approved, the Department implemented a campaign submitted by an advertising firm on 28 April 1986. This campaign included a new promotion strategy that involved a musical video, a record, and hot air balloons. On 29 April 1986 a contract for $650,000 - the entire advertising budget - was signed with the advertising firm.

3.45 In early July 1986, the Department requested Treasury Board to include funding for this program in Supplementary Estimates. Approval was granted on 23 July 1986, approximately one and one-half months after Environment Week. Treasury Board noted that approval had been sought after the expenditure had been incurred, and expressed reservations about the value of the program. Treasury Board made it clear that its retroactive approval of the $1 million should not be viewed as an endorsement of the program or the actual activities carried out in support of it.

3.46 **Contract compliance**. We have serious concerns regarding the $650,000 contract with the advertising firm. The contract contained the following components:

Component	Cost
Video and record	$ 370,000
Hot air balloons	80,000
Other	127,000
Sub-total	577,000
Commissions on the above	73,000
Total	$ 650,000

3.47 The contract allowed the advertising firm to be reimbursed for actual expenditures reasonably and properly made to acquire goods and services from outside suppliers at the suppliers' price, plus 17.65 per cent commission on some expenditures to cover overhead and profit. Copies of the suppliers' invoices and other supporting documentation were to be submitted to the Department.

3.48 The advertising firm subcontracted the entire project to two corporations, with both receiving fixed-price contracts for the full $577,000. This negated the "cost plus" nature of the main contract, and ensured that the Department would be billed the full $650,000. There was nothing in the main contract that prevented this from occurring.

3.49 For example, $80,000 plus commissions of $14,120 were budgeted for hot air balloon events. Because of safety concerns, five of the six events were cancelled. The subcontract, though, permitted the subcontractor to bill the entire $80,000 even in circumstances such as these. Accordingly, the subcontractor billed the advertising firm $80,000, and the advertising firm in turn billed the Department $80,000 plus $14,120 in commissions.

3.50 We also found that the Department did not have sufficient information to ensure that the advertising firm complied with the terms of the contract. For example, the Department paid $370,000 to the advertising firm for the video and record without ensuring that the full amount had been paid to the subcontractor. Our audit evidence indicates that approximately $70,000 of the $370,000 was never paid to the subcontractor. Of the $70,000, approximately $40,000 related to the production of 50,000 records, and the Department had not ensured that all 50,000 records had, in fact, been produced. Also, it did not question whether it should have made any payments at all with respect to the records, even if they had been produced.

3.51 **Distribution of profits**. All profits arising from the sales of the record and video were to go to a non-profit corporation, the Canadian Artist Foundation for the Environment Ltd. (CAFFE). This corporation, directly under the control of the performing artists themselves, was to distribute funds to various deserving national Canadian environmental groups and agencies.

3.52 In July 1986, the letters patent of the Corporation were amended to allow the Minister to appoint a member to CAFFE's Board of Directors. Discussions with the member indicated that he was not aware if any Board meetings had taken place, and was not aware of the financial position of CAFFE or the source and disposition of its funds. At the time of our audit, the Department did not have any pertinent financial information on CAFFE. The disposition of the sales proceeds in excess of manufacturing costs, if any, and the disposition of related royalties, has yet to be determined.

3.53 Department of External Affairs - Premature delivery of a computer system, to avoid lapsing funds at year end, and delays in renovations by Public Works Canada

> In January 1986 the Department of External Affairs contracted for the purchase of a computer at a cost of $1.3 million for processing import permits. However, because the site could not be ready until August, the delivery at year end was made in advance of need, in order to avoid lapsing funds. This resulted in an opportunity cost of $50,000. Further delays occurred in preparing the site, delaying implementation an additional six months and resulting in foregone savings of $725,000.

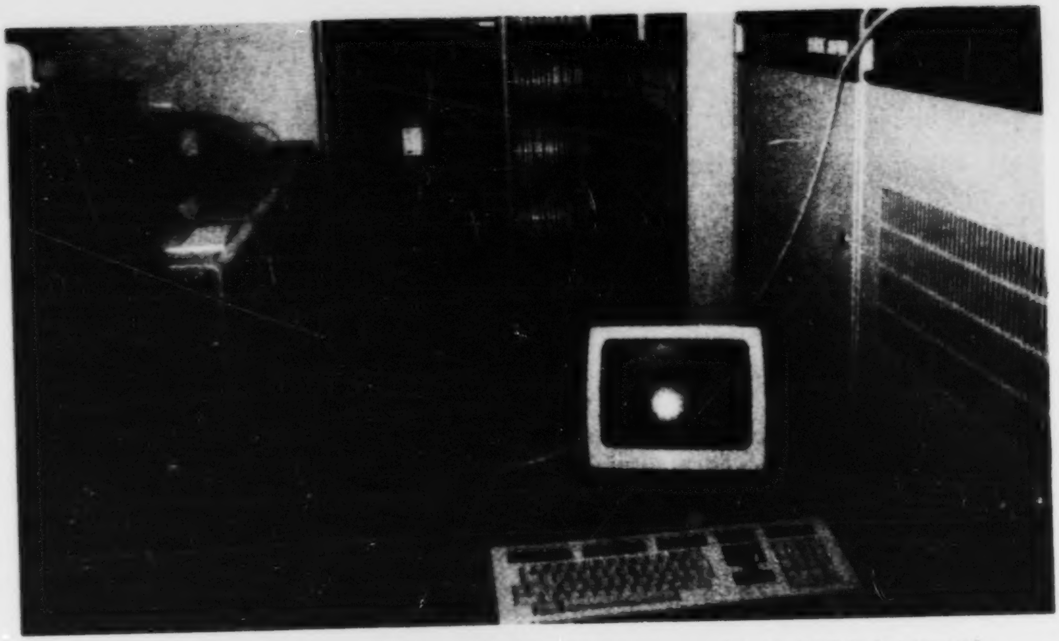
3.54 In October 1985, External Affairs obtained Treasury Board approval to spend $1.3 million to implement a computer system to issue import permits. The Department originally estimated savings of $80,000 per month from this acquisition; the monthly saving realized once the computer was operational was $145,000.

3.55 Public Works Canada was contacted on 25 February 1986 to make architectural, mechanical and electrical renovations to a building to accommodate the new computer. External Affairs assumed that this construction work would be finished by 1 August 1986 and that the system would be operational by 1 October 1986. This would allow termination of a service bureau contract by 30 October 1986. Public Works Canada determined that these targets could not be met and, in consultation with External Affairs, produced a revised target occupancy date of 27 August 1986.

3.56 These targets were not met. The computer room construction was not finalized until 24 September 1986, the system was not operational until 27 January 1987 and service bureau processing was not ended until 20 March 1987 - almost five months behind schedule. This delay increased operating costs by $725,000 over budgetary projections.

3.57 The Department was concerned that if the purchase was not completed before the end of the fiscal year 1985-86, the project might be indefinitely postponed. Funds were available in 1985-86 but future year funding was planned for other projects. Thus payment by year end became a prime consideration because otherwise funds would lapse.

3.58 Planning for the computer acquisition did not follow appropriate procedures to ensure due regard to economy. A clause was put into the contract requiring the supplier to have the system available for shipment by 31 March 1986. The supplier met this commitment.



Delays in setting up this computer for processing import permits resulted in increased costs to the Crown (see paragraph 3.58).

However, because the computer room was not ready, a departmental representative acknowledged acceptance on March 31st at the supplier's premises and left the computer stored there until mid-September when space was finally available. Also, the supplier's bill was paid in 12 days rather than the 30 days called for in the contract. The full amount was remitted even though installation and testing had not been completed.

3.59 The impact of these decisions was that an asset costing $996,000 sat idle and provided no benefit whatever for almost six months. Assuming 10 per cent financing, this cost the Government of Canada almost $50,000 in imputed borrowing costs.

3.60 One reason for not realizing the Department's expectations and for incurring the extra expense was that the Department did not involve Public Works Canada at a sufficiently early stage to set a realistic delivery date. External Affairs initially contacted Public Works Canada on 25 February 1986 - a month after the Letter of Intent was sent to the supplier and two days before the contract was signed. Public Works Canada claims that its late involvement made it impossible to attain the August 1st scheduled completion set by External Affairs.

3.61 Contracted work was not performed by DPW to External Affairs' satisfaction. Time commitments were not met, and a relatively small project costing less than $125,000 took seven months to complete. Serious air conditioning problems arose that delayed the system's start-up and interfered with processing. Public Works Canada assisted in resolving difficulties but only after numerous petitions from External Affairs and after considerable time was lost.

3.62 Department of Finance and Canada Deposit Insurance Corporation - Possible tax avoidance

> The transaction that resulted in the Canada Deposit Insurance Corporation paying $200 million to facilitate the sale of the Bank of British Columbia was structured in way that could be regarded as an attempt to avoid income taxes.

3.63 During our audit of the 31 December 1986 financial statements of the Canada Deposit Insurance Corporation, we examined the $200 million payment made by the Corporation to facilitate the sale of the Bank of British Columbia to the Hongkong Bank of Canada.

3.64 The House of Commons was informed that there would be no impact on the Government deficit arising out of the $200 million payment, and that the money was to provide a capital provision of $200 million for the Hongkong Bank of Canada to use as a source of capital, as a provision against future loan losses and as a capital base. Under the Income Tax Act, assistance provided by the Canada Deposit Insurance Corporation to the Hongkong Bank of Canada would be subject to Canadian income taxes.

3.65 For the transaction to take place without any impact on the deficit, the receipt of the $200 million by the Hongkong Bank of Canada would have to be subject to Canadian income taxes, and the Canada Deposit Insurance Corporation's $200 million cost would have to ultimately be borne by its member institutions through tax deductible premium payments.

3.66 The agreements, however, were structured so that the $200 million was paid by the Canada Deposit Insurance Corporation to the Hongkong Bank of Canada's parent in Nassau. The agreements also required the Hongkong Bank of Canada's parent to provide it with a capital reserve of $200 million. The $200 million made a circle – it went from the Canada Deposit Insurance Corporation in Canada to an account of the Hongkong Bank of Canada's parent in Nassau and found its way back to the Hongkong Bank of Canada in Canada.

3.67 We asked officials of the Department of Finance if the $200 million would now be subject to Canadian income taxes. Although officials of the Department of Finance were involved in negotiating the transaction, they advised us that the $200 million may or may not be taxable and that was a matter for Revenue Canada, Taxation to determine (see Exhibits 3.1 and 3.2).

3.68 If the transaction was not taxable, using a 50 per cent rate for federal and provincial income taxes, the $200 million cost would ultimately be shared equally by federal and provincial governments and the Canada Deposit Insurance Corporation's member

Exhibit 3.1

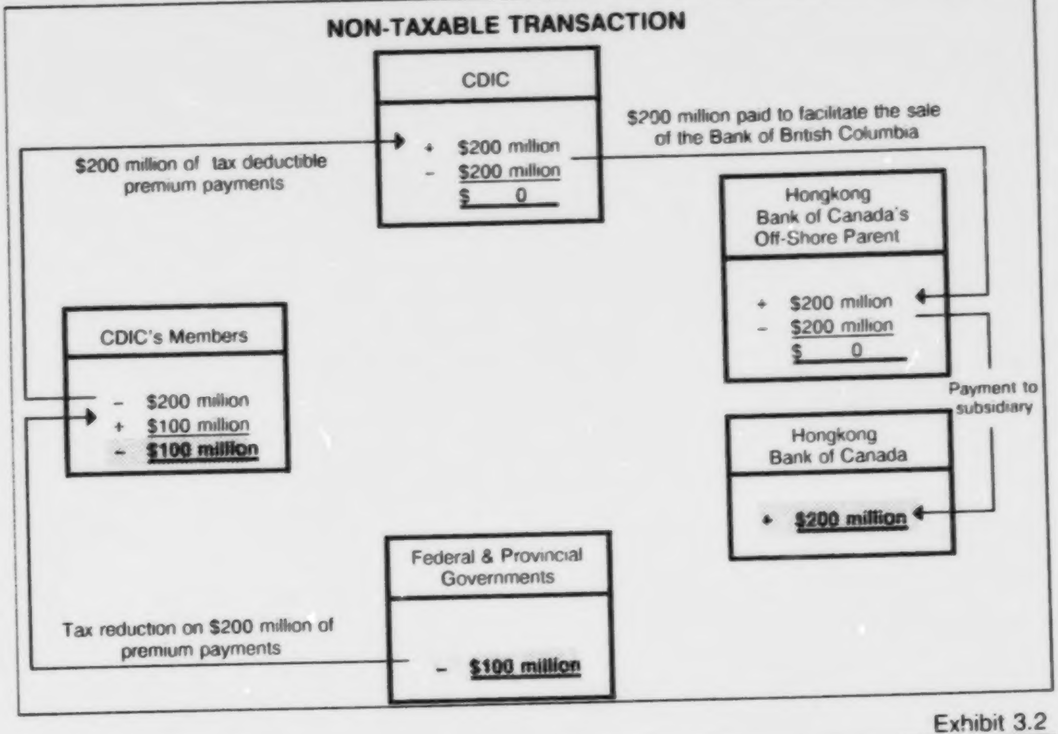
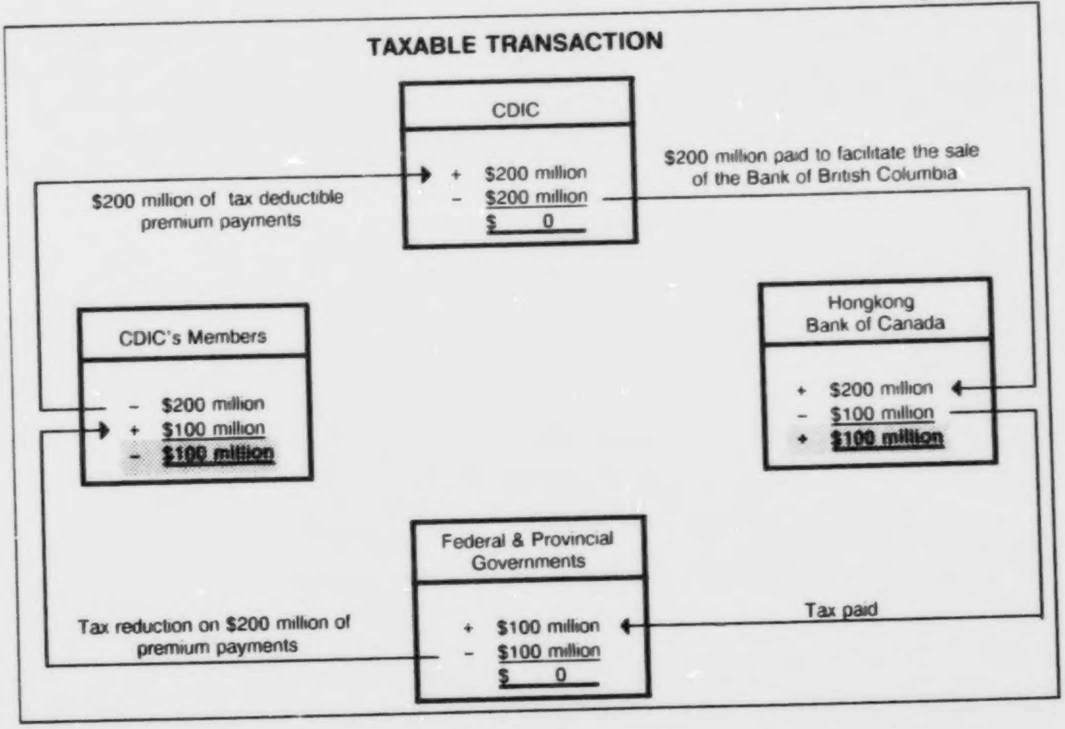

NON-TAXABLE TRANSACTION
CDIC
+ $200 million
– $200 million
$ 0
$200 million paid to facilitate the sale of the Bank of British Columbia
$200 million of tax deductible premium payments
Hongkong Bank of Canada's Off-Shore Parent
+ $200 million
– $200 million
$ 0
CDIC's Members
– $200 million
+ $100 million
– $100 million
Payment to subsidiary
Hongkong Bank of Canada
+ $200 million
Federal & Provincial Governments
– $100 million
Tax reduction on $200 million of premium payments

Exhibit 3.2


TAXABLE TRANSACTION
CDIC
+ $200 million
– $200 million
$ 0
$200 million paid to facilitate the sale of the Bank of British Columbia
$200 million of tax deductible premium payments
Hongkong Bank of Canada
+ $200 million
– $100 million
+ $100 million
CDIC's Members
– $200 million
+ $100 million
– $100 million
Federal & Provincial Governments
+ $100 million
– $100 million
$ 0
Tax paid
Tax reduction on $200 million of premium payments

institutions and it would have an impact on the deficit. We therefore undertook a detailed analysis of the income tax implications of the transaction.

3.69 We concluded that one of the main reasons for having the $200 million payment made off-shore was to attempt to avoid subjecting it to Canadian income taxes. In our opinion, and in the opinion of legal counsel, the structuring should prove to be unsuccessful in avoiding taxes.

3.70 We recognize that all corporations and individuals are entitled to minimize their taxes within the limits of Canadian tax law. We are concerned, however, that officials of federal government departments and a Crown corporation were involved in a transaction that could be regarded as an attempt to avoid income taxes. This could seriously undermine the integrity of the income tax system.

3.71 Department of Public Works - Amounts not recovered from Canada Post Corporation

> Department of Public Works records indicate that a substantial receivable is outstanding from Canada Post for costs and fees relating to the operating costs of buildings and to tenant services with respect to properties under the administration and control of, or occupied by, Canada Post. At 30 June 1987, over $30 million recorded as receivables from the Corporation were in dispute and had been outstanding for over a year.

3.72 Since 1982, Canada Post has engaged Public Works Canada as real property manager and service agent under an agreement.

3.73 Despite lengthy negotiations, Public Works and Canada Post have not been able to agree on the application of certain clauses described in general terms in the agreement. These clauses relate to the establishment of a weighted occupancy factor in allocating operating costs of buildings, the cost of employer's share of contribution to employee benefit plan for departmental employees working in the Canada Post facilities, and fees and costs charged for tenant services.

3.74 The agreement states that the Corporation will remit to Public Works a monthly payment for operating costs of buildings based on an annual cash budget, with adjustments to actual figures every six months. However, recently the two parties have not been able to agree on an annual work plan that would be the basis for developing the budget referred to in the agreement.

3.75 In May 1986, the two parties agreed to settle the 1985-86 operating costs of buildings at $125 million. This agreement was reached due to the lateness of the Public Works billing information. However, there is now a disagreement over what costs were included in this settlement since Public Works, because of problems with its billing system, manually billed Canada Post an additional $13 million that was not included in the normal billing process.

3.76 At 30 June 1987, $30 million recorded as receivables from the Corporation were in dispute and had been outstanding for over a year.

3.77 In addition, according to the agreement, rental revenue collected by Public Works on behalf of Canada Post will be passed to the Corporation. To date, approximately $1 million of this revenue has been held back by Public Works.

3.78 In April 1987 Canada Post drafted a proposed settlement, and negotiations between the two parties to resolve these outstanding amounts are continuing. However, if the amounts in dispute cannot be resolved in a mutually acceptable manner, the matter should be referred to the appropriate policy committee of Cabinet for a decision as provided for in the agreement.

3.79 Department of Regional Industrial Expansion - Overexpended Appropriation

In 1986-87, DRIE's authorized expenditures for grants and contributions under Vote 10 were set at $789,009,000 in the Main Estimates. This was increased by $10,000,001 through Supplementary Estimates to $799,009,001. At the end of the fiscal year, DRIE reported a total appropriation utilization of $878,782,237. This was $79,773,236 more than the amount authorized.

3.80 The funds used by DRIE in 1986-87 were made up of cash outlays and amounts charged to 1986-87 under the Payable at Year End (PAYE) policy. In 1986-87, DRIE's actual cash expenditures were $777.6 million, and PAYE items were recorded as $101.2 million, for a use of appropriation totalling $878.8 million.

3.81 Under the PAYE policy, unpaid debts owing in respect of obligations incurred prior to the end of a fiscal year are recorded as expenditures against the appropriation for that fiscal year. This permits Parliament to get a picture of the total use of an appropriation that is more accurate than if only actual cash outlays were recorded. If a department does not have enough funds left in its appropriation to pay amounts owed as a result of PAYE items, the actual payment of the debt must be made from the next fiscal year's appropriation. This means that a department's available budget in the second year is reduced by the amount of the first year's over-utilization.

3.82 Forecasting the amount of likely expenditures in a particular fiscal year is difficult for large grants and contribution programs. Many projects involve multi-year commitments, and the timing of the flow of funds can depend on the actions of others that must incur costs and then seek reimbursement from DRIE according to whatever cost-sharing arrangement is in effect.

3.83 By late May 1986, DRIE was aware that the proposed regional and headquarters budgets for grants and contributions were more than the funds available. One of the reasons that DRIE did not react to the early indication of over-expenditure was that over the past few years, DRIE had lapsed funds. In 1985-86, DRIE's lapse was $219.4 million. As a result, DRIE's internal practice was to discount staff expenditure forecasts and assume that funds would turn out to be available at year end.

3.84 The environment changed in 1986-87. As part of general fiscal restraint, DRIE's authorized budget was lower than the previous year, and DRIE had agreed to a further reduction of $45 million as part of the special $500 million reduction in spending for 1986-87. Yet DRIE continued to approve new projects without adequate recognition of its existing commitments and the impact of its lower budget. Our analysis indicates that $121.8 million of DRIE's expenditures related to projects that were approved in 1986-87.

3.85 **Department of Transport - Failure to establish the financial controls necessary to protect a $16.7 million financial interest of the Crown**

> The Department of Transport surrendered options with the two national railways to purchase, for $1.00, equipment valued at $37 million, without ensuring that the financial interests of the Crown were protected. The Department did not determine the market value of the equipment or perform an appropriate analysis of its options. In the case of Canadian Pacific Railway, it did not obtain a commitment covering the work to be done in exchange for the surrender of its option, valued at $16.7 million. In addition, the Department did not include an audit clause in the agreements or make progress reports to Treasury Board as required.

3.86 The Prairie Branch Line Rehabilitation Program is a $1,072 million 12-year project that began in 1977. From 1977 to 1983, four agreements were entered into by the Department of Transport with both of Canada's national railways under which the Crown financed the acquisition of equipment costing approximately $60 million that was to remain in the name of the railways. The agreements included an option for the Crown to acquire this equipment from each railway for $1.00 at the end of these agreements.

3.87 In subsequent agreements the Department agreed to value the equipment at $37.3 million but also agreed not to exercise the options to acquire the equipment for $1.00 in return for work to be performed by the railways. These fixed price agreements were signed in 1984 after obtaining Treasury Board approval. We have several concerns with the new arrangements arising from the revised agreements.

3.88 **Valuation of equipment.** In determining the proper consideration for the equipment, the Department did not conduct an appraisal to obtain fair market values, but agreed to value the equipment at the net book value of $37.3 million. An appraisal would have provided a better picture of the full consideration the railways were to receive under the agreements.

Equipment used on the Prairie Branch Line Rehabilitation Project. The Department had options from two railways for one dollar each to purchase similar equipment, valued at $37.3 million. The Department surrendered the options in exchange for future work by the railroads, but the financial interest of the Crown was not fully protected (see paragraph 3.87).

3.89 **Agreements.** The annual work schedules prepared under the agreement with Canadian National Railways disclose the cash cost to the Crown of each project and the value of work to be performed in lieu of the equipment surrendered. However, as Exhibit 3.3 indicates, the annual work schedules and the agreement with Canadian Pacific Railway include no provision for any work to be done in exchange for the equipment surrendered. The Department has not provided us with a valid explanation for this significant omission in the Canadian Pacific agreement.

3.90 **Financial controls.** We noted that, contrary to the Treasury Board requirements for contribution agreements, no audit clause was included in the new agreements. We also noted that adjustments made as a result of audits under the previous four agreements resulted in recoveries of $14 million from both railways. In our opinion, such audit provisions would have provided useful compensating controls to assist the Department to monitor the railways'

Exhibit 3.3

EXTRACTS FROM THE 1984 AGREEMENTS

	Railway	
	Canadian National	**Canadian Pacific**
Description	millions of dollars	
Value of work to be performed over 5 years per 1984 agreements and related work schedules	$ 285.7	$ 255.0
Consideration		
Cash payment by the Crown per agreements	265.1	255.0
Agreed value of equipment for which $1 purchase option not exercised by the Crown	20.6	16.7
Total	285.7	271.7
Contribution for which no offsetting work can be identified	$ 0	$ 16.7

compliance with the agreements and to ensure the Department will receive full value from the railways. In addition, contrary to Treasury Board requirements, to date the Department has not submitted progress reports on this major Crown project to Treasury Board. Also, because of the non-cash nature of the $37.3 million consideration provided to the railways when the Department surrendered its $1.00 equipment purchase options, the real cost of the program from 1984 onwards has not been disclosed to Parliament in the Estimates.

3.91 These financial controls and reports are particularly important because subsequent to the signing of the agreements in 1984, many changes have been made to the annual work schedules in the agreements as a result of delays, postponements, changes and cancellations of projects, approval of new projects, and reprofiling as a result of budgetary constraints.

3.92 Overall, we concluded that in the absence of these financial controls, there is no assurance that the Crown has received full value for surrendering its $1.00 option to acquire equipment from CP Rail that has an agreed value of $16.7 million.

3.93 The Department states that it has attempted to ensure that fair and reasonable value is obtained from the railways and that it will pursue the issue of monitoring the equipment credit over the balance of the contract. All future contribution agreements will contain an appropriate audit clause in accordance with Treasury Board requirements, and from now on progress reports on this major Crown project will be submitted.

FINANCIAL MANAGEMENT AND CONTROL STUDY

FINANCIAL MANAGEMENT AND CONTROL STUDY

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4

FINANCIAL MANAGEMENT AND CONTROL STUDY

Introduction

4.1 How governments spend the money they collect has been of concern since taxes were first levied. Financial control has always been considered the first step in protecting the public purse. It has been built into legislation in Canada since 1867.

4.2 Financial *control* means that assets owned by the government should be properly recorded and protected; accounting data should be accurate and reliable; and funds should be spent only for those purposes stated and within the limits approved by Parliament. All this is based on good internal control systems designed to protect against error or fraud.

4.3 Financial *management* means that decision makers such as Parliament, ministers and departmental managers should know the financial implications of their decisions. Operations should be carried out with due regard to economy, efficiency and effectiveness. And information should be available to hold managers accountable for their use of resources.

4.4 The Government of Canada formalized this concept following the recommendations of the report of the Royal Commission on Government Organization in 1962. Programs were to be designed to meet government objectives. Funds were to be voted on and managed on the basis of a plan, and then their use was to be reported against that plan.

4.5 Since this concept of financial management took hold in the early 1960s, there have been major changes in technology. Government operations have become exceedingly complex. Government spending has increased substantially, and new programs have sprung up to meet the needs of various groups in society.

4.6 The financial environment in which government operates has also changed, particularly in recent years. The government has found itself facing large deficits while the public continues to demand new or improved programs. The government's theme has been to try to do more with less. In this environment, good financial management is essential.

Purpose of this Study

4.7 The purpose of this study was to examine and assess the adequacy of financial management and control practices across government. To do this, we selected a number of departments that we believe are representative of government operations (see Exhibit 4.1).

Exhibit 4.1

DEPARTMENTS INCLUDED IN CURRENT FINANCIAL MANAGEMENT AND CONTROL STUDY*

	Departmental Expenditure (Gross) ($000s)	Departmental Non-Tax Revenue (Gross) ($000s)
Agriculture	1,764,129	549,056
Customs and Excise	415,283	22,018
Employment and Immigration	5,619,188	927,894
External Affairs	803,441	56,634
Transport	3,466,266	1,063,513
Supply and Services	929,811	760,239
Veterans Affairs	1,536,321	37,589
Energy, Mines and Resources	3,332,998	1,406,470
Health and Welfare	26,239,038	161,290

*figures taken from 1985-86 Public Accounts

4.8 Between 1974 and 1976, the Auditor General carried out a major study of financial management and control in government. The Office of the Comptroller of the Treasury had been abolished in 1969. The Auditor General's study was to determine whether departments had set up the necessary systems and procedures to discharge their financial responsibilities.

4.9 The study concluded that they had not. The Auditor General stated that both financial control and financial management were "grossly inadequate" and wrote that he was "deeply concerned that Parliament – and indeed the Government – has lost, or is close to losing, effective control of the public purse".

4.10 In 1975 and 1976, the Auditor General made a number of recommendations aimed at correcting the situation. Since then, the government has responded to virtually all these recommendations. Most were designed to set up the systems and procedures the study had found lacking.

4.11 Since 1975, the Office of the Auditor General has examined various aspects of financial management and control as part of departmental and other audits. But there had been no comprehensive study by the Office of the Auditor General to determine the effect of the government's initiatives on the adequacy of financial management and control practices across government.

Scope of the Study

4.12 In our 1974-76 study, we reviewed financial management and control in all departments and agencies and in many Crown corporations. This time we restricted our review to the nine departments shown in Exhibit 4.1. The scope of audit in each of these departments is described in the departmental chapters in this Report. We reported on the Department of Veterans Affairs in our 1986 Report.

Government Expenditures

4.13 In this study we excluded certain government expenditures from the scope of the study. Exhibit 4.2 shows the breakdown of government expenditures by type of payment. We did not review public debt charges or agencies and Crown corporations. Although we did not look specifically at defence spending as part of this study, Chapters 9 and 10 reflect a number of financial management issues in materiel support and major capital projects in the Department of National Defence.

4.14 We examined transfers and subsidies to see whether controls were in place to ensure that the right people were getting the right amounts.

The Financial Management Cycle

4.15 Exhibit 4.3 shows the financial management cycle common to all departments.

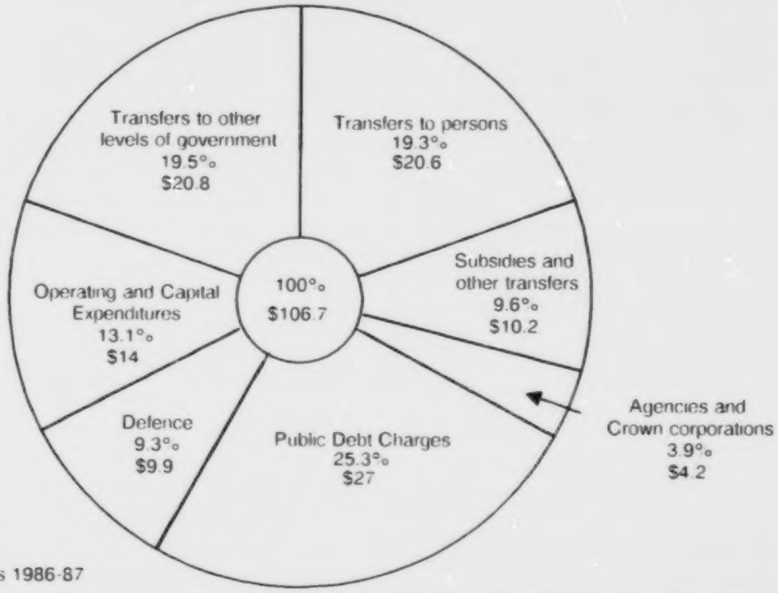
4.16 We examined the four elements of the cycle with a view to determining whether the necessary links between elements were present and whether each of the elements worked effectively. Because of the importance of information throughout the whole cycle, we examined the way departments develop the information systems they need and the quality of information generated by these systems. Our study was based on criteria drawn from policies, directives and guidelines issued by the Treasury Board Secretariat and the Office of the Comptroller General.

Planning and Budgeting

4.17 A fundamental assumption underlies the financial management cycle: good management requires sound planning. This assumption is reflected in all the government's initiatives to improve financial management since 1962. The current government planning system (the Policy and Expenditure Management System or PEMS), set up in 1979, is based on the same premise that underlay earlier systems; that is, that policies cannot be determined properly without regard to their resource implications and that expenditures cannot be planned properly without reference to policies and objectives.

Exhibit 4.2

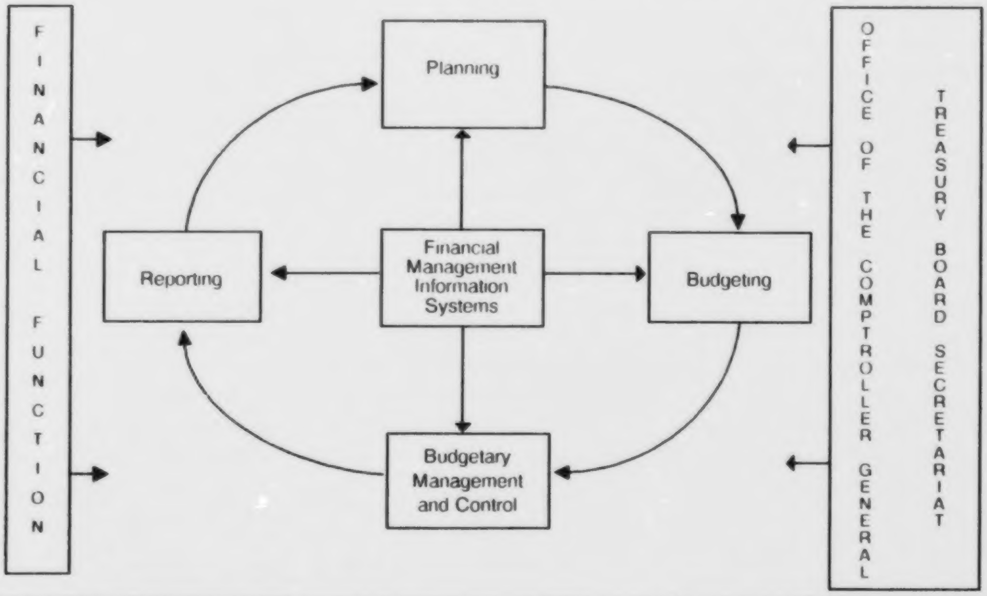
GOVERNMENT EXPENDITURES BY TYPE OF PAYMENT
1986-87
(in billions of dollars)



Source: Main Estimates 1986-87

Exhibit 4.3

THE FINANCIAL MANAGEMENT CYCLE


FINANCIAL FUNCTION
Planning
Reporting
Financial Management Information Systems
Budgeting
Budgetary Management and Control
OFFICE OF THE COMPTROLLER GENERAL
TREASURY BOARD SECRETARIAT

4.18 We examined Operational Plan Frameworks, which describe the basic structures for presenting programs for resource allocation purposes to central agencies. They are intended to provide the framework within which departments manage resources and eventually report results to Parliament. They should define what a department plans to accomplish and describe the linkage between objectives, results and resource levels. We also looked at the multi-year operational plans. These are the financial plans that reflect these linkages.

4.19 We reviewed how departments justify their requests for resources. We examined new initiatives proposed by departments to see whether they disclosed both the anticipated benefits and full costs of the projects. And we looked at how departments were managing cut-backs and whether they have ranked and costed their activities.

Budgetary Management and Control

4.20 Once funds have been allocated, departments need to have the information to ensure that expenditures are made with probity and with due regard to economy, efficiency and effectiveness. We examined whether departments had adequate internal controls. We looked at whether they were using performance indicators, where appropriate, to measure their efficiency and effectiveness. We examined what information was available to manage assets. In those departments that collect non-tax revenue, we looked at what information was available for setting fees and collecting money.

Reporting

4.21 The final element in the management loop is to give the people who allocate resources information about how – and how well – those resources were used. We examined the accuracy and appropriateness of information provided to departmental managers, Treasury Board and Parliament. We did not review the Public Accounts. Volume 2 of the Public Accounts, which captures detailed information on departments, was being revised by the Office of the Comptroller General to correct weaknesses that had been identified.

4.22 We did not examine the quality of information provided by internal audit and program evaluation reports. Both areas were subjects of recent government-wide studies by our Office. Program evaluation was followed up in 1985 and 1986.

Financial Management Information Systems

4.23 Good management depends on good information. Changes in technology have increased the amount of information available. They have also changed the way managers can get at information. We evaluated the departments' use of management information systems. We assessed whether the information provided by these systems was accurate, complete, relevant and available at appropriate times. We examined whether the systems met managers' needs in a cost-effective manner.

Role of the Financial Function

4.24 Each department has a senior financial officer. This officer has two roles. The first is to maintain essential financial control. The second is to provide managers with reliable, complete and relevant financial information, advice and services. We examined how financial officers, under the direction of the senior financial officer, were carrying out this role.

Role of the Agencies of Treasury Board

4.25 Under the Financial Administration Act, Parliament assigned overall responsibility for financial management to the Treasury Board. We did not audit the Treasury Board Secretariat or the Office of the Comptroller General. But we did examine their mandates to identify their roles in assisting the Treasury Board in ensuring that departments meet the statutory requirements for financial management and control. When we discovered problems in departments we looked at the adequacy of the initial direction provided by these central agencies as well as the nature of their monitoring to determine whether they initiated corrective measures.

Main Messages

4.26 Financial control is a fundamental responsibility of departmental management. The government spends over $100 billion a year. It is essential that the right amount be paid to or received from the right person at the right time. A decade ago there was little assurance that that was happening. Basic controls were missing or were inadequate. This is no longer the case. There have been major improvements in control practices and procedures in departments, and there is no indication that fundamental control weaknesses are widespread.

4.27 But apart from ensuring that the correct amounts are paid to the right people, government needs to know that the payments help meet its objectives of government and that programs are delivered with due regard to economy and efficiency. This is financial management. For the approximately 50 per cent of government expenditures that are statutory transfer payments, this means that information on the effectiveness of programs should be available to Members of Parliament so they can assess the need for or desirability of legislative changes. In the case of government operations, financial management also means knowing the costs of new initiatives and having the information to assess whether operations are carried out with due regard to value for money.

4.28 Financial management is still not satisfactory either on a government-wide basis or within most individual departments. The concept is simple – objectives, results and resources should all be linked. The application is difficult and is hampered by the fact that the information and other tools needed to do this are often not available.

4.29 On a government-wide basis, a central planning system was developed based on linking objectives, resources and results. But the system that was established is so complex that departments have rarely been able to use it to manage operations. It has also not provided the means for holding departments accountable for their use of resources.

4.30 The central planning system is based on the expectation that programs can have clear objectives that could then be translated into specific results. It requires that the results of the hundreds of activities carried on in a department be aggregated to provide a link with program objectives. It also requires that the linkages between resources and results be aggregated so that Treasury Board can use them as the basis for reviewing and approving resources.

4.31 Because the expectation is unrealistically high, the information available from departments is inadequate. This means that government does not have the information required to optimize the use of resources or to hold departments to account for the way they spend the money they are given.

4.32 In attempting to establish a complex, uniform expenditure management system, central agencies appear often to have under-emphasized the fact that good financial management in government is the sum of good financial management in all its departments and agencies. In encouraging departments to meet the requirements of the centre, they often neglected to ensure that departments were applying good financial management practices within their operations.

4.33 Departments set up processes and systems to meet central agency requirements. In many cases, however, these have not been useful for managing their own operations. While some departments have set up alternative mechanisms for this purpose, many have not. Several things that could and should have been done were not. Few good measures of efficiency exist, even in organizations running routine processing operations. Although there is more information available to manage operations, it is often not better information. Until recently, the preoccupation of departmental managers on not exceeding appropriations or lapsing funds has meant that the emphasis has been on controlling cash, not managing resources.

4.34 Throughout our study, we found that management is often considered to be something separate from financial management. Financial officers are not routinely providing program managers with relevant information that links operational and financial data. At times this appears to have been caused by their lack of understanding of what program managers were doing. At other times, it appeared that program managers saw little use for this type of information. Our interviews with a number of senior government managers indicated that their priorities were set by those with power over their careers. They see their overwhelming priorities to be delivering services and providing information to show that they did not overspend and that money was used only for the purposes intended. The efficient, economic and effective use of resources is a much lower priority. Under these circumstances, it is not surprising that financial management has not evolved to any great extent.

4.35 This is not to say that there has not been progress over the past decade. There are tools in place that, if properly refined and used, could provide necessary support to new management initiatives. Program evaluation provides one means of determining the effectiveness of government activities. Part III of the Estimates has done much to provide Members of Parliament with more information on departments. In departments, there is now a greater interest in financial management and control. We have noted in several departments the steps taken by senior managers to improve the information about the financial implications of the decisions they are called upon to make. In many cases, the shortage of resources has made managers aware of the need to use what resources they have more efficiently and effectively.

4.36 Several of the departments we examined have made considerable progress in the past two years. But there is a need for continued, strong senior management commitment and direction to ensure that managers at all levels are aware of their financial responsibilities, are given the tools to carry them out, and are held accountable for the results produced.

The Background

4.37 Financial control was built into legislation as soon as Canada became an independent country. Various laws have been passed since then to improve control over public funds. As well, two Royal Commissions had included in their mandates a review of financial management and control. Exhibit 4.4 shows the historical development leading to current practices.

The Royal Commission on Government Organization, 1962

4.38 This study laid the framework for the current organization of government operations. The Glassco Commission's mandate was to recommend changes that would promote efficiency, economy and improved service. The philosophy underlying its recommendations has often been summed up by the phrase "let the managers manage".

4.39 In the area of financial management and control, the Commission made a number of recommendations. On the planning side, these were designed to shift the emphasis in the Main Estimates from the nature of expenditures to their purpose. This was done to permit a valid assessment of requests for resources and departmental performance. It would also allow Members of Parliament to form an objective judgement on the desirability of continuing or modifying specific programs in the public interest.

4.40 Responsibility for financial control was to be given to departments. They were to operate within common policy guidelines. Senior financial officers were to be appointed in each of them. Departments were to be responsible for developing their own financial systems, and they were to adopt modern management reporting techniques.

4.41 Many of the recommendations touched on the nature and quality of information provided to Parliament. This was to allow the House of Commons to perform its function as custodian of the public purse.

Exhibit 4.4

MAJOR LEGISLATION AND STUDIES IN FINANCIAL MANAGEMENT AND CONTROL SINCE CONFEDERATION

1867 – The British North America Act
- created the Consolidated Revenue Fund

1878 – The Public Accounts Audit Act
- created the Office of the Auditor General

1931 – The Consolidated Revenue and Audit Act
- created the Comptroller of the Treasury

1951 – The Financial Administration Act
- replaced the 1931 Act
- assigned responsibility for financial management to Treasury Board

1962 – The Royal Commission on Government Organization (Glassco)

1969 – The Government Organization Act
- abolished the Comptroller of the Treasury
- granted autonomy to the Treasury Board Secretariat

1977 – The Auditor General Act

1978 – Amendment to the Financial Administration Act
- created the Office of the Comptroller General

1979 – The Royal Commission on Financial Management and Accountability (Lambert)

1984 – Amendments to the Financial Administration Act
- strengthened the control and accountability of Crown corporations

Financial Management and Control Study, 1974-76

4.42 The Auditor General initiated this study to assess the adequacy of systems and controls in departments and agencies. This was done in light of the additional responsibilities delegated to departments after the Glassco Report. In the 1975 and 1976 Reports the Auditor General expressed serious concerns about the adequacy of systems and procedures for financial management and control. He concluded that financial management and financial control systems were substantially below acceptable standards of quality and effectiveness.

The Royal Commission on Financial Management and Accountability, 1979

4.43 The Lambert Commission confirmed the Auditor General's findings. It also identified a number of defects in the organization and processes of government. The Commission believed these had led to a breakdown in the accountability chain. The problems included a lack of effort to establish clearly defined objectives against which the performance

Exhibit 4.5

INITIATIVES IN FINANCIAL MANAGEMENT AND CONTROL SINCE 1975

1978 – Office of the Comptroller General established

1978 – Office of the Comptroller General issued standards for Internal Financial Audit

1979 – Policy and Expenditure Management System (PEMS) introduced

1979 – IMPAC initiated by the Office of the Comptroller General

1981 – Program evaluation guidelines published

1981 – Part III of the Estimates introduced as part of the reform of the Estimates

1985 – Cash Management policies and directives issued

1986 – Increased Ministerial Authority and Accountability (IMAA) introduced

of departments could be measured. Also, there was no process in place to exact an accounting. And financial and other information essential to measuring performance in relation to objectives was missing.

4.44 The Commission recommended major changes in the way departments should be held accountable and in the way government should be managed.

Major Initiatives since 1975

4.45 Exhibit 4.5 shows when the major initiatives in the area of financial management and control over the past decade were started.

Financial Management

4.46 For good financial management to exist, two elements must be satisfied. First, decision makers should have the information necessary to allocate resources and to manage operations with due regard for economy, efficiency and effectiveness. Second, managers must account for how they used the resources they were given.

Financial Information for Allocating Resources and Managing Operations

4.47 There is a massive amount of data available from the various accounting systems across government. The Department of Supply and Services alone produces in excess of 40 million pages of financial information each year. This is supplemented by the millions of pages generated internally by departmental systems. We estimate that departmental information quadruples the amount of data available. Although much of this consists of lists of financial transactions – some 77 million transactions are entered into the Central Accounting System each year – a significant amount is in the form of management reports (summaries, balances, and status reports). But this vast amount of data on revenues and expenditures rarely translates into the financial information managers need to manage.

4.48 For financial information to be useful to managers, it must be timely, accurate, complete and relevant. How these terms are defined varies according to how information is to be used. But for most managers, if financial information is to be relevant, it must also be related to operational information.

4.49 In the last few years there have been significant changes in the technology for producing information. Printed reports are no longer the only way of receiving information. Managers often now have access to terminals linked to large corporate computer systems. Or they use stand-alone microcomputers. These are having a major effect on the way managers obtain and use information. Increasingly, managers are demanding information that can be tailored to their personal needs.

Information for new initiatives

Information provided to decision makers on major capital projects or new program initiatives is improving, but it is still inconsistent in quality and depth.

4.50 When looking at new proposals, decision makers should have an analysis of alternatives presented to them. This would include cost-benefit analyses based on the costs of the project during its life and a realistic assessment of its benefits. In previous years we reported that new initiatives were normally supported by lengthy narratives but few hard facts about costs. Although that is no longer true for major capital projects, other new initiatives are still often not supported by adequate information despite changes in the overall environment for government spending.

4.51 The number of costly new initiatives put forward in the past few years has decreased. But there are shifts of resources within departments as managers adapt their programs to changing needs. Because new money is not readily available, departments are trying to provide better information to the central agencies to justify their requests. In dollar terms, the largest amounts are allocated to major Capital projects. These are capital projects in excess of $100 million. About 75 per cent of the dollar value of projects originates in the Department of National Defence, with the Department of Transport accounting for much of the rest. Both these departments have central groups that provide a strong internal challenge to project proposals before they are submitted to Treasury Board. This has led to more thorough appraisals of a number of new projects. But even a strong internal challenge depends on complete financial information and a clear definition of needs.

4.52 Few departments other than Transport and National Defence have established strong mechanisms for internal challenge. Therefore, the quality of information in submissions to Treasury Board varies considerably. For example, National Health and Welfare provided the cost implications of alternative ways of providing non-insured health benefits to native people. But as described in Chapter 12, a better challenge to proposals in its Fitness Program could have avoided unnecessary expenditures of $670,000. Even in the Department of Transport, the improved challenge process does not yet apply to smaller projects. In these cases, decisions are sometimes based on insufficient information and analysis (see Chapter 13).

4.53 We are particularly concerned about the poor information provided by most departments in their requests for funds for new automated financial management information systems. As indicated in Exhibit 4.9, few projects have been completed within the original budget. Part of this involved mismanagement of projects, but most project proposals overstated their benefits and understated their costs by a large margin. Nor does this seem to be improving in the current environment. Four of the departments we audited are installing central financial information systems based on the same software package. Yet the projected cost to develop these systems, as set out in submissions to the Treasury Board, varies from $500,000 to $4.8 million.

4.54 We concluded that major capital project proposals are being supported by better financial information and are generally being challenged more rigorously. But improvements are needed to ensure that program initiatives and smaller capital projects, especially systems development projects, are supported by sufficient financial information and challenged by those responsible for allocating scarce resources.

4.55 **Departments should make certain that a strong internal challenge mechanism is in place to ensure that the needs definition, life-cycle costs and potential benefits of all new initiatives are fully considered and documented.**

Information for budgeting

We had expected to find information on expected results and the anticipated costs of producing them supporting budget presentations. Instead we found that most budgets were based mainly on prior years' costs.

4.56 Budgets are designed to show what resources are necessary to meet various goals. We expected to find certain kinds of information supporting requests for funds. This would include, where possible, performance expectations for efficiency (such as cost per cheque) and effectiveness (such as the number of jobs to be created by a job creation program) and information on costs. Where such measures are not available or appropriate for the program, we expected to find periodic reviews of activities (A-base reviews) and program evaluation reviews and for their results to be incorporated into the financial plans. We rarely found that this was the case.

4.57 In 1975 we were concerned about the quality of information in departmental budgets. We still are. Today, there is more attention given to planning. However, what is produced, though often very detailed, is not the right kind of information. It is almost impossible to challenge budgets objectively. Most budgets are based on historical data. They are important but they are not sufficient. Statements of results are imprecise. Information on the cost of products or services is still inadequate. There are few performance indicators. Service levels are often not defined. Where the nature of operations made this type of data inappropriate, good proxy measures do not often exist. These shortcomings mean that decision makers do not have the information to ensure that they allocate resources in the most efficient or effective manner.

4.58 Frequently we found very detailed work plans in support of budgets. This is much more than existed a decade ago, but work plans still need to be improved if they are to be useful management tools. Work plans state what activities a manager plans to carry out during the year. This can be a useful operational tool, but we found that work plans rarely link the resources being requested to the specific results planned. Hence they are not usually valuable financial management tools.

4.59 All the departments we audited have had cuts in resource levels. These include the 4 per cent cut in capital funding in 1985-86 and the $500 million government-wide cut in 1986-87. In many departments we found that the cuts were not based on objective information about the efficiency of operations. Under such conditions, efficient managers are penalized.

4.60 Budgeting remains primarily a process of allocating available resources based on their actual use in previous years. There is still too little consideration given to operational efficiency and cost effectiveness in the budgeting process.

4.61 **Departmental budgets should be improved so that, where practical, financial requirements are linked to expected results.**

4.62 Managers require financial information to assist them in monitoring and controlling their operations. This includes information on costs, performance measures, and assets that allows them to know what they have done, what it cost and how well they did it. As well, financial officers and others with spending authority require accurate, timely and reliable information to ensure probity and to control spending. The information to control spending is readily available. The information to manage it is not.

4.63 Systems in the Department of Supply and Services and in departments provide managers with regular data on expenditures and revenues. These data show them where they stand in relation to budget. They allow managers to find out if they are overspending or underspending their allotments and to take corrective action if necessary. In general, managers consider these data reliable. But, in a period of restraint, managers want this information even sooner so as to be able to reallocate funds if necessary. Many departments are planning to develop even more sophisticated central financial systems to respond to this need for more current allotment and commitment control information.

Managing operations

Most departments have the information needed to ensure that they do not overspend their budgets. However, financial and operational data are usually not pulled together. Managers seldom have the information needed to know whether their operations are economic, efficient and effective.

4.64 But financial management information is not readily available. The Department of Supply and Services system was designed to provide financial data. Moreover, few of the departmental systems set up to provide for the specific needs of departments have provided both financial and operational data. Information on expenditures and revenues is readily available. It tells managers where they stand in relation to their budgets, but it does not give them information on the cost-effectiveness of their operations. Although operational data are available, they can rarely be related to the financial data so as to determine the cost of specific operations.

4.65 Line managers have seldom relied only on the large systems to meet their information needs; they have usually had their own informal 'black book' systems. With the advent of microcomputers many of these have become quite sophisticated. When they are used for specific purposes this works well. Potential problems exist, however, if they are used to provide information to higher levels of management that must be integrated with similar information from other systems. Because most of the black books have been developed individually and are not integrated or reconciled with departmental systems, there is a danger that the information received at very senior levels is neither consistent nor reliable. The use of micros can be a cost-effective way of providing information to managers. But some co-ordination is needed to ensure that systems are designed to produce reliable and consistent information.

4.66 In addition to information on operations, most departments need specific information to manage the assets under their control. Assets include such things as real property, inventory and accounts receivable. The type of information needed varies from department to department or even within departments depending on the nature and use of the asset. The information available, however, is often poor or incomplete.

4.67 In those departments where we examined the management of assets (five of the nine), we identified problems in all of them. Many were attributable to poor or incomplete information. For example, Energy Mines and Resources has 6 different inventory systems; the Department of External Affairs has 12. Although these may be justifiable where the nature of the inventory is different, problems arise because different valuation methods are used in the different systems. In several departments, there was no assurance that all inventory was recorded. Corporate information is incomplete. In the case of Energy, Mines and Resources, this has led to concern about the control over these assets (see Chapter 7). In the case of External Affairs, the Department estimated its five-year replacement cost for furniture and equipment to be $160 million. It has no means of validating the planning assumptions to ensure this amount will meet its needs economically, efficiently or effectively (see Chapter 8).

4.68 In Chapter 10, Materiel Support in the Department of National Defence, we reported on various weaknesses in its inventory management system and practices. We estimate that inaccurate requirement calculations, inadequate training of supply managers and inadequate monitoring contributed to purchases in advance of needs of $35 million for fiscal 1986-87. The reported value of potentially disposable holdings as defined by the Department, excluding items retained for emergency purposes, is approximately $300 million. Estimated annual costs for holding these items in inventory is about $60 million.

4.69 Property management has not been supported by adequate information. The Department of Agriculture, for example, does not have complete information on the use of property and the maintenance requirements for facilities (see Chapter 6). Moreover, capital projects have been undertaken with poor assessments of their needs.

4.70 Departments should ensure that managers are provided with the means to integrate financial and operational data where appropriate. Departments should ensure that all assets are recorded and valued appropriately.

4.71 There are three fundamental pieces of information needed to ensure that resources are allocated and operations managed with due regard for value for money: information on effectiveness, information on efficiency, and information on costs.

Information on effectiveness

At the Program level few ongoing measures of effectiveness have been developed. Even at the operational level there are few ongoing effectiveness measures. Program evaluation, which should provide periodic reviews of effectiveness, has not yet covered most of the activities of departments.

4.72 The concept underlying financial management is that objectives, results and resources should be linked. This is the rationale underlying government's attempts to measure the effectiveness of its programs.

4.73 The government has two formal mechanisms that require the measurement of effectiveness of programs. The first is the Operational Plan Framework. The second is program evaluation.

4.74 The Operational Plan Framework (OPF) is a document prepared by each department setting out the structure of its programs. It divides each program into Planning Elements. Each is to have a results statement and a linkage statement showing how this element contributes to the program objective. Each Planning Element must also have a linkage statement that matches resources with results. Exhibits 4.6 and 4.7 explain the components of an Operational Plan Framework.

4.75 The OPF is a significant element of the government's current approach to resource allocation and accountability. It is based on the expectation that program objectives can be stated clearly and that what programs are meant to achieve can be clearly identified. It requires that the results of activities at operational levels in departments be aggregated to produce meaningful statements of results at the Planning Element level. It also implies that a few broad performance measures reflect the way operations are managed and controlled within a department.

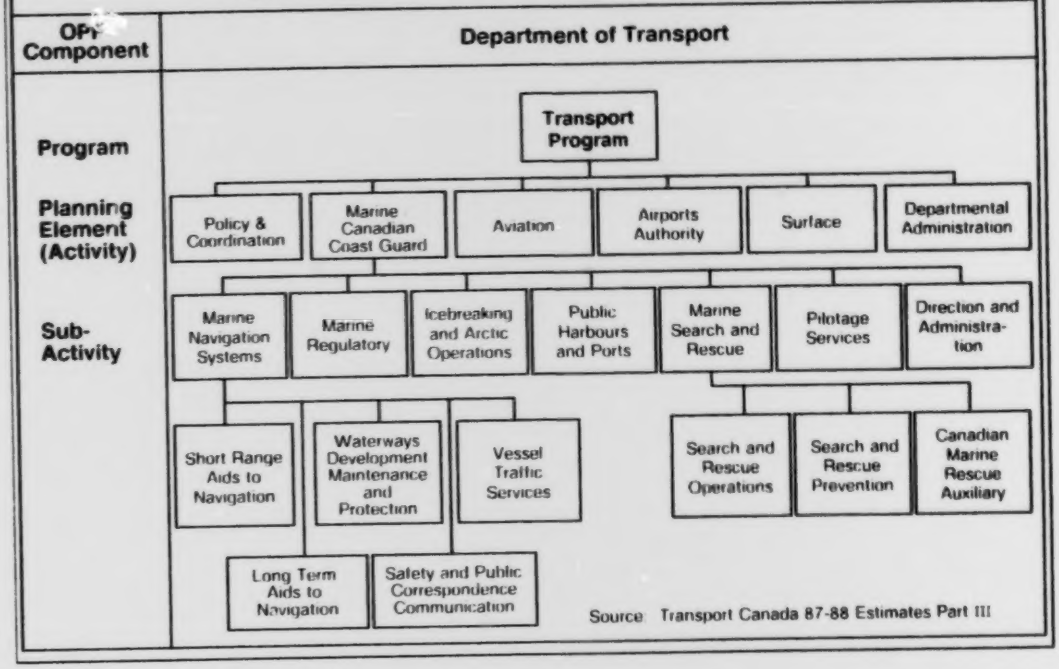
4.76 The current Operational Plan Frameworks have yet to achieve most of the objectives set for them. In most departments they have resulted in a clearer definition of the activities carried out and the broad intent of these activities. Almost all departments now request funds in the annual budgeting exercise on the same basis they use to organize their activities. The Treasury Board has approved the OPFs of most departments, albeit with caveats. Most of these caveats arose because results statements were not expressed in specific terms, and linkages between objectives and results and between results and resources were not clear. None of the departments we examined has been able to produce an Operational Plan Framework setting out intended results consistently and in a clear and measurable way showing specific linkages between resources consumed and results achieved at the aggregate level required by central agencies.

4.77 For example, in the Department of Supply and Services, the results statement for the Accounting, Controls and Standards Group is "to maintain and prepare the central accounts of Canada". The linkage statement is, "to carry out the above activity in a responsive manner the following resources are necessary - $x,xxx and xxx person-years". There is no rationale provided for the resources requested and no indication of the effect on results if more or fewer resources were made available.

4.78 There appear to be several reasons for the failings of Operational Plan Frameworks. Most of them indicate that the expectations for OPFs are unrealistically high. First, the objectives for programs as stated in legislation and regulations are often broad and imprecise. Also, programs often have multiple or unstated objectives. As a result, managers have considerable difficulty translating objectives into clear, measurable and attainable statements of purpose to be pursued by their organizations. Second, at the Planning Element level, there are similar difficulties in setting clear objectives and specific results that reflect the sum of the results of the Planning Element's constituent operations. The activities carried out at lower levels are often so diverse that aggregation is rarely meaningful. Exhibit 4.6 shows the variety of activities within a Planning Element. We found performance indicators at lower levels but could rarely find how they related to program objectives. Finally, the organization of many departments we reviewed has not been stable enough to allow the development of a meaningful Operational Plan Framework. When reorganization affects the composition of Planning Elements, a new framework is required.

Exhibit 4.6

DEPARTMENTAL OPERATIONAL PLAN FRAMEWORK


OPF Component
Department of Transport
Program
Planning Element (Activity)
Sub-Activity
Transport Program
Policy & Coordination
Marine Canadian Coast Guard
Aviation
Airports Authority
Surface
Departmental Administration
Marine Navigation Systems
Marine Regulatory
Icebreaking and Arctic Operations
Public Harbours and Ports
Marine Search and Rescue
Pilotage Services
Direction and Administration
Short Range Aids to Navigation
Waterways Development Maintenance and Protection
Vessel Traffic Services
Long Term Aids to Navigation
Safety and Public Correspondence Communication
Search and Rescue Operations
Search and Rescue Prevention
Canadian Marine Rescue Auxiliary

Source: Transport Canada 87-88 Estimates Part III

Exhibit 4.7

OPERATIONAL PLAN FRAMEWORK
EXPLANATION OF KEY TERMS

OBJECTIVES are clear statements of why an activity is being carried out.

RESULTS STATEMENTS are statements of

(a) outcomes (what is to be achieved)
(b) outputs (goods produced or services performed)

LINKAGE STATEMENTS are statements of

(a) how results help meet objectives
(b) the relationship between the level of resources and expected results

PERFORMANCE INDICATORS are

(a) effectiveness measures (how outcomes would be measured)
(b) efficiency measures (the relationship of resources used to outputs)

4.79 We conclude that Operational Plan Frameworks, in their present state of development, are not yet useful tools for making objective decisions about resource allocation and do not provide an adequate basis for accountability. The level of aggregation demanded in them is unrealistic in most cases either for statements of results or meaningful performance indicators.

4.80 **The Treasury Board should re-examine policy underlying the Operational Plan Frameworks. In conjunction with departments, central agencies should determine which programs have clearly stated objectives that can be translated into measurable result statements. They should then determine at what level performance indicators are useful for measuring the cost-effectiveness of a program. Where program objectives are unclear or do not lend themselves to measurement, central agencies and departments should determine at what level results statements would be possible and useful to Treasury Board and to departments. Where results are not measurable, central agencies and departments should agree on what proxy measures would be appropriate.**

4.81 We had not expected to find efficiency measures in all departments. But we did expect to find them where routine processing operations are being carried out. We reviewed productivity in selected areas of the Department of Supply and Services. We also followed up on our 1985 observations on efficiency measures in Income Security Programs at National Health and Welfare. These departments employ large numbers of staff performing operations such as cheque processing, application processing and other tasks that lend themselves to the measurement of efficiency including the quality and level of service. In other departments we examined whether efficiency measures existed and were incorporated into budgets. Where measures did not exist we looked at what information was available to assess the efficiency of operations.

Information on efficiency

With few exceptions, information on efficiency of operations is inadequate to support resource allocation or to ensure the efficient management of available resources. The proportion of resources covered by performance measures is low. Most performance standards are based on historical data, with no assurance that these in fact represent efficient standards of performance. Information on efficiency is rarely integrated with financial information.

4.82 Most of the performance measurement systems we reviewed had been developed with little guidance from the Office of the Comptroller General, which has functional responsibility for this area. Three of the systems were discontinued after considerable effort and expenditure. In a number of instances the role of performance measurement was not clear. There are few requirements to report regularly on efficiency, either within departments or for external reporting purposes such as resource justification.

4.83 In both Supply and Services and National Health and Welfare the efficiency standards were inadequate. The standards were based on historical data with insufficient analysis to show that the standards represent efficient levels of performance. For example, Regional Operations in Supply and Services plans to use current productivity levels as the basis for their proposed performance measurement system, even though there are indications that current levels need to be improved.

4.84 The Excise Branch of Customs and Excise has developed a performance measurement system covering some of their operations. Data from this system are not totally linked with those from the financial systems for resource allocation or budgetary management purposes. Still, the information enables managers to assess actual efficiencies in terms of what could or should be achieved.

4.85 Where performance measurement systems did not exist we found little evidence of ad hoc studies on operations that would ensure that they were being carried out efficiently. The lack of integration of operational and financial data makes it difficult to assess the cost effectiveness of operations.

4.86 **Departments should ensure that efficiency measurement systems exist in those operations that lend themselves to this type of measurement. These systems should be based on objective standards of operational efficiency, should cover the majority of resources in the operation and should be integrated with financial systems. The Office of the Comptroller General should monitor the development of these systems.**

Information on costs

The cost information required for making decisions on the allocation of resources and the management of operations is often not available.

4.87 There is a need for better cost information in government. Both the Glassco Commission and the Lambert Commission reported that better information on costs was needed for efficient operations.

4.88 Information on costs is needed for almost all decisions. The kind of information required may vary depending on what it is being used for: recovering costs, allocating resources, comparing similar operations, privatizing operations or making operational decisions.

4.89 The type of cost information and the level of detail required vary with the activity and the use to which the cost information is put. Where the information is not needed on a regular basis, a one-time or periodic costing exercise may be appropriate. At the other extreme would be an ongoing cost system integrated fully with other departmental systems. No single system can be applied uniformly across government. The cost information should be appropriate to the activity and to the purposes for which the information will be used.

4.90 The costs of some of the services provided by government are recovered from users. Airports, food inspection, and issuing passports are some of the services for which some or all the costs are recovered. To set rates that cover costs, a department must know what these costs are. We would expect them to include the direct costs of the activity, together with an appropriate portion of overhead. This can be done. Revolving funds are the most common mechanism for capturing these costs in government. The Passport Office at the Department of External Affairs has used this mechanism well to recover the cost of issuing passports. Other departments are not as advanced. For example, even though 100 per cent cost recovery is not a departmental objective, the Department of Transport was not fully aware of the amount of cost recovery it was achieving on a "product-line" basis. An initial analysis recently done by the Department revealed that operating costs for nine major airport terminal buildings exceeded operating revenues by $61.2 million (see Chapter 13).

4.91 Increasing pressures to restrain or reduce government expenditures are leading to difficult choices among alternatives. As indicated earlier, full life-cycle costs are required for new initiatives. These costs do not usually require elaborate systems, just the determination of all costs and the various factors that influence them. Departments increasingly provide these costs to decision makers in support of proposals for new initiatives. However, continuing operations require a different type of information on costs. All managers should have information on the costs they can control. At lower levels this may be relatively limited, but it increases at higher levels in the department. The lack of reliable information on the cost of activities limits the ability of managers to weigh the costs and benefits of various alternatives.

4.92 Cost information is also needed to compare the costs of similar activities, both within departments and in other governmental bodies. In Chapter 11 on Supply and Services Canada we show the results of comparing the costs of some of the Department's routine activities with the costs incurred for similar activities in some provincial government departments. This type of analysis helps to highlight areas that require investigation to see why some cost elements are higher than in other government operations. This could also assist departments to identify opportunities for improving efficiency and reducing costs.

4.93 Departments should determine what cost information they require and set up the appropriate mechanisms to gather it.

Information for Financial Accountability

4.94 The final element in financial management is meeting the needs of departmental managers, Treasury Board and Parliament for financial accountability. Financial accountability is the responsibility of managers to account for the manner in which they have fulfilled the financial responsibilities entrusted to them. Accountability thus entails providing information on what activities were carried out, showing that the activities were carried out with the greatest possible degree of efficiency, prudence and probity, and giving information about the extent to which the activities achieved what was intended.

4.95 In 1962, Glassco stated: "Where there is delegation, there must also be an assessment of the manner in which authority is exercised and responsibility discharged, and performance must be measured against the goals pursued". Parliament is responsible for the public purse. It decides what it wants done and how much it is prepared to spend to do it. Departments are then responsible for carrying this out within the framework provided by central agencies. Parliament has given some financial responsibilities to departments and others to the Treasury Board. Treasury Board in turn has delegated some of its authority to departments. In departments, authorities have been delegated to managers at all levels. We would therefore expect to find mechanisms for financial accountability within departments, between departments and Treasury Board and, finally, between departments and Parliament.

Financial accountability in departments

Financial accountability within departments is weak. In the departments we reviewed, few of the mechanisms that form the basis for management contracts link operational and financial performance.

4.96 Many departments have developed management contracts' which are statements of performance negotiated annually with managers who will later be appraised against them. These statements are based on objectives set by the deputy minister and translated into operational terms by program managers. Work plans usually form the basis for these contracts. As indicated earlier, there have been considerable efforts to develop these, but their quality and content vary substantially both within departments and from one department to the next. Managers report periodically on their progress against these plans. Most of the progress reports we reviewed discussed technical or operational outputs as well as the achievement of certain administrative objectives such as affirmative action.

4.97 For these documents to act as financial accountability documents, they must provide information that relates operational performance and financial performance. Limited information exists for managing operations; it is therefore not adequate for performance reporting purposes either. Because of this and other factors, managers tend not to be held accountable for the efficient use of resources.

4.98 In departments with revolving funds, there is a tool for financial accountability. In some cases it works. In the Department of External Affairs, the Passport Office operates under such a system. Although we have reported on some problems with the cost information it includes (Chapter 8), it is still a good example of what can be done. Not only does the Passport Office system provide financial information for determining the cost of issuing a passport, it provides operational information to determine whether these costs are reasonable. Because the Passport Office is going through technical changes, it is reassessing its operational standards to ensure they are reasonable.

4.99 In our opinion, although accountability is improving in departments, there is still too little emphasis on financial accountability. We found few examples where managers were held to account for the efficiency or cost-effectiveness of their operations, although they were held accountable for ensuring that their budgets were not overspent or allowed to lapse.

4.100 **Performance appraisals involving management personnel should include assessments of the management of resources in relation to results achieved.**

Financial accountability to Treasury Board

There is no comprehensive and systematic financial accountability mechanism between departments and the Treasury Board. A recent Treasury Board initiative, "Increased Ministerial Authority and Accountability", is designed to fill this gap.

4.101 Treasury Board has overall responsibility for financial management as part of its role as the general manager of government. This means that it should have information to ensure that good financial management and control exist in departments and agencies. At present, there is no comprehensive and systematic mechanism to do this. Reviews tend to be ad hoc and designed to address specific issues. Most reports requested by Treasury Board Secretariat or the Office of the Comptroller General appear to be for information purposes rather than for reasons of control or accountability.

4.102 The Glassco Commission thought that accountability should be an integral part of the delegation of financial control that it recommended in 1962. The Lambert Commission believed that it was the lack of accountability for the use of resources that had led to the breakdown in financial management and control. In the absence of effective accountability mechanisms, central agencies have issued increasingly detailed directives on all aspects of management. There are 60 chapters of administrative policies and 23 volumes of personnel policy guidelines. They do not address any department specifically but apply uniformly to all departments. In addition, there are directives that are specific to individual departments.

4.103 The government has initiated "Increased Ministerial Authority and Accountability" (IMAA) to fill this accountability gap. It is designed to be tailored to each department and is based on a Memorandum of Understanding signed by the minister, the deputy minister, the President of the Treasury Board and the Secretary of the Treasury Board. This document sets out the financial and administrative authority to be given to a department. It also sets out a framework for accountability by specifying what the department is to accomplish within a specific time and what information it is to provide as a basis for reporting on its performance in relation to the goals agreed on. This initiative addresses the Lambert Commission's concern that the lack of a financial accountability mechanism within government has meant that there has been no way of ensuring that "power is directed toward the achievement of broadly accepted national goals with the greatest degree of efficiency, effectiveness, probity and prudence".

4.104 Although we agree with the principle underlying IMAA, we have a number of reservations. A main concern is that Treasury Board has stated that IMAA will be relying on certain existing mechanisms – mechanisms that we have found don't work well.

4.105 The basis for financial accountability is to be the department's Operational Plan Framework. As we reported earlier, this is not yet a useful document. Even if a Memorandum of Understanding were based on lower-level performance indicators, we have found that good indicators rarely exist. Treasury Board has also said that there must be adequate planning, controlling and reporting processes in departments as well as good internal audit and program evaluation groups. Few departments can meet all these requirements.

4.106 Setting goals as foreseen in the Memorandum of Understanding involves having a long-term view of operations. Program objectives can usually be met and their results measured only after several years. Periodic assessments are required to ensure that things are moving in the right direction. Operational initiatives are shorter-term in nature, but they should still fall within the longer-term perspective. Many of them also require several years to bear fruit.

4.107 IMAA recognizes this in that it foresees a longer-term review cycle, normally three years. But to achieve operational and strategic objectives over this period requires that the organization be stable in terms of the tenure of senior managers. Recent history suggests that this is next to impossible. Exhibit 4.8 shows the average tenure of ministers and deputy ministers over the past 11 years in the departments we audited.

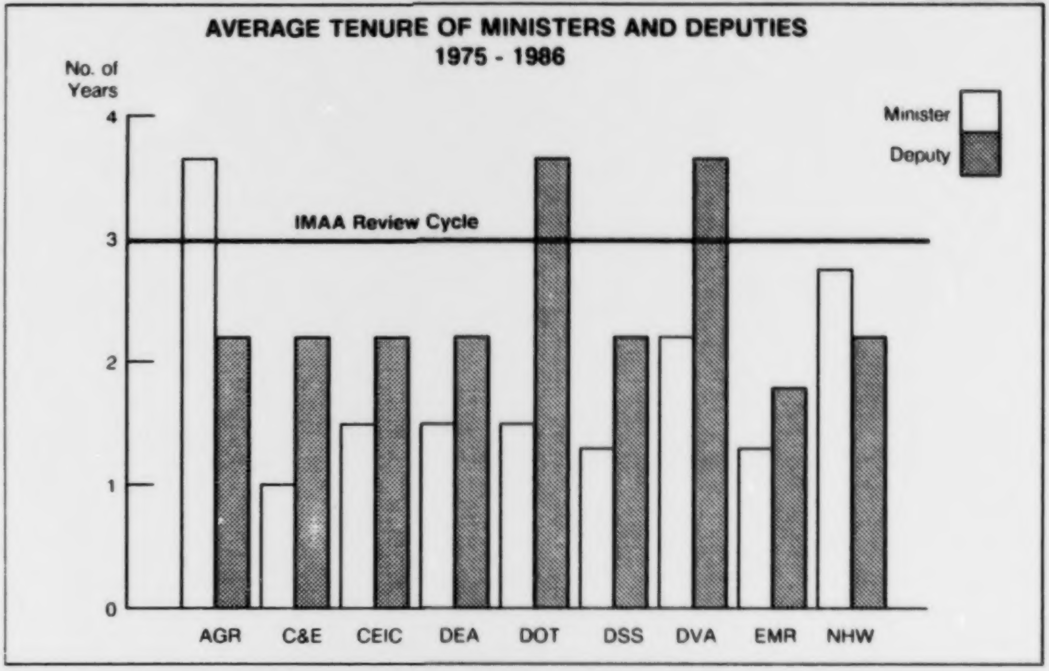
4.108 The Public Accounts Committee has expressed concern over the current short tenure of deputy ministers. We concur. Without a good understanding of the operations of their departments, deputies are unlikely to be able to determine the best way of directing operations to meet the requirements of the government.

4.109 Formal financial accountability to the centre has been weak. There has been little effective monitoring carried out by the central agencies of the financial performance of departments. Although IMAA may correct this situation, few departments appear to qualify for inclusion because of the weaknesses of their systems. Also some stability will be required in departments to see that the goals outlined in the Memorandum of Understanding are met.

Financial accountability to Parliament

4.110 One important role of Members of Parliament, and in particular members of standing committees, is to scrutinize the proposals, policies and actions of the government. The Federal Government Reporting Study, published in 1986, reported that MPs want and need access to consistent and understandable data that would assist in identifying the right questions to ask in making their assessments. They want financial information to be consistent (over time and from different sources), easy to obtain, quickly digestible and easy to understand. Now they receive the three volumes of the Public Accounts and the three parts of the Estimates. The Federal Government Reporting Study dealt with the summary-level information MPs suggested was missing, the information that would allow them to see the overall size and shape of government together with trends in key financial indicators.

Exhibit 4.8



4.111 Our study did not examine the Public Accounts. We limited our review to Part III of the Estimates and to the annual reports produced by departments.

Part III of the Estimates

Information to Parliament has improved following the introduction of Part III of the Estimates. There are still major weaknesses, however, in information required for financial accountability.

4.112 Part IIIs were introduced with the tabling of the 1982-83 Estimates. According to Treasury Board Circular 1982-8, they were designed "to provide for all programs of each department, details of planned and actual results, related expenditures, other performance data useful in justifying resource requirements and sufficient background information to provide a basic understanding of each program". They perform the last function well.

4.113 Part IIIs provide Parliament with more, better and timely information on government programs. This is a considerable improvement over what we reported in 1975. There is still room for improvement, however, in the way departments describe how resources will be used to produce results. Where practical, operational goals should be given. Accounting for accomplishments with resources previously approved could then be more meaningful. Information on what has been accomplished with resources received in previous years is inadequate for the purposes of accountability.

Information available to Parliament through the Estimates for 1987-88 compared to 1974-75.

4.114 Whether departments can use the Part IIIs to report on the efficient and effective use of resources depends very much on the adequacy of the planning systems they represent. Where performance reporting is weak or unreasonable, the Part IIIs will reflect this situation. Because measures of efficiency and cost information rarely exist, they are rarely reported in the Part IIIs.

4.115 We found the Part IIIs repetitive and hard to read. One of the difficulties with these documents is that all departments must report the same kind of information in a standard format. This is intended to ensure consistency so that MPs can follow the documents more easily. There is certainly consistency of format, but this often results in very general and unfocused information being provided. The Office of the Comptroller General is planning to experiment with different formats of Part III presentation for a small number of departments in 1988.

4.116 Part IIIs are doing a good job of describing what each program does. In most cases, the structure used for reporting clearly reflects the businesses the departments are in.

4.117 Some departments are not including important information in the Part IIIs on spending or on the financial effects of certain initiatives. In all the departments we reviewed, there were problems with the information provided to track major spending initiatives. About half the initiatives were not costed. Many were not reported consistently from year to year. Progress is often not reported and Parliament is not always told when a project has been completed. The capital projects schedule in the Department of External Affairs Part III illustrates the problems (see Chapter 8).

4.118 Since one of the objectives of Part III is to inform Parliament of spending plans for each program, we expected to find information on significant spending initiatives or on policy changes affecting the way a program is delivered. There were several cases where this did not occur. For example, in the Department of Agriculture (Chapter 6), no mention was made of an expected $1.4 billion deficit in the Western Grain Stabilization Fund.

4.119 Because Parliament is the custodian of the public purse, it is essential that Members of Parliament be given the information they need to carry out their responsibilities. Part IIIs have done this to some extent, but further improvements are required. We are examining the kind of information MPs use and want and how Part IIIs can respond to these needs. We will be reporting further on this in 1988.

4.120 Part IIIs are a very important information link between departments and Parliament. They provide good program information but are weak in providing meaningful information on which Members of Parliament can base assessments of program performance.

4.121 **Performance information in Part III of the Estimates should be improved to increase its usefulness as an accountability document. Where it is not possible to provide quantifiable data, a narrative approach should be used. Departments should ensure that important initiatives are identified and reported on a comparable basis from one year to the next until the initiative has been completed.**

Annual reports

Since the introduction of Part III of the Estimates, most departmental annual reports no longer serve an identifiable purpose.

4.122 Before Part IIIs were introduced, annual reports were the main documents for reporting on programs. Each department's enabling legislation requires the appropriate minister to table an annual report. The acts do not specify what these reports should contain, so although there is a legal requirement to report, departments have not identified the purpose of the reports or the intended audience. There are no standards of form or content.

4.123 There are also other annual reports produced as a result of specific legislation. In a number of cases, such as reports from the Canadian Dairy Commission, the information is precise and useful because the audience is readily identifiable.

4.124 **The Office of the Comptroller General should re-examine the purpose of and the need for departmental annual reports. If they are to be continued, some minimum standards of form and content should be set.**

Financial Control

Significant improvements have been made in financial controls since our 1974-76 study. The government has systems and procedures that provide basic financial controls; departments have corrected most of the fundamental weaknesses noted at that time.

4.125 Financial control means that assets owned by the government should be properly recorded and protected; accounting data should be accurate and reliable; and funds should be spent only for those purposes stated and within limits approved by Parliament. All this is achieved by good internal control systems designed to provide internal checks and accounting control over financial transactions.

4.126 In light of the billions of dollars spent and collected by the government each year, adherence to sound financial control principles is crucial if there is to be adequate control by the government of funds appropriated for its use by Parliament.

4.127 Our 1974-76 study revealed serious weaknesses in basic financial control areas, such as segregation of duties, spending authorization, accounts verification, requisitioning and distribution of cheques, receiving and depositing of public money, and control over assets. The results of that examination led us to conclude that financial control systems in departments and agencies were grossly inadequate.

4.128 Although we did not carry out a detailed review of internal accounting controls in the present study, we did review the results of the work carried out as part of our annual audit of the Public Accounts, as well as the conclusions of departmental internal audit reviews conducted in the last three years.

4.129 Significant improvements in financial control have been made since our earlier study. Departments have corrected most of the fundamental weaknesses noted at that time. Departments have systems and procedures that provide basic financial controls. For example, all the departments in the study have documented control procedures and financial manuals, where previously there had been little such documentation. No major problems have been found in the segregation of financial responsibilities. When we consider the major inadequacies in financial controls reported in 1975, this is a substantial improvement.

4.130 But problems still exist. Last year we reported on the absence of essential financial controls in the Department of Veterans Affairs (see 1986 Report, paragraphs 13.64 to 13.67). The Department has given high priority to correcting the weaknesses we identified, and it has significant actions under way. Control weaknesses have also been identified in all other departments. At present these problems are not a threat to fundamental financial control. They should, however, be addressed and corrected.

4.131 One element of public sector financial control is that systems and procedures should be in place to ensure that funds are spent only for the purposes intended and within limits approved by Parliament.

4.132 We noted several instances in the last five years of failure to comply with or questionable compliance with parliamentary authorities. Our 1986 report on the Department of Agriculture commented on this problem with regard to payments under the Agricultural Stabilization Act.

4.133 As part of the examination of government departments, the Auditor General examines expenditures against votes to ensure that authorized levels are not exceeded. Although some instances of violations have been identified and reported in recent years, we are generally satisfied that departments have adequate controls in place to ensure that spending does not exceed the levels authorized by Parliament. In fact, controlling funds and person-years within allotments and appropriations is very much the preoccupation of financial officers and senior management. However, because of the impact of restraint and the difficulty in forecasting the timing of payments accurately, departments with large grants and contributions programs will need to examine their cash flow forecasting systems to ensure they can avoid problems such as noted this year in the Department of Regional Industrial Expansion (see Chapter 3).

4.134 Another aspect of financial control is ensuring the accuracy and reliability of financial information. Examinations conducted in recent years by our Office have not identified major weaknesses in internal control over accounting data in departments. This leads us to believe that the quality of internal control over accounting data is adequate at the departmental level.

4.135 Finally, financial control includes the safeguarding of assets. The government owns a vast and diverse range of assets – land, buildings, laboratories, ships, aircraft and airports to name but a few. The government also has financial assets such as cash, investments and receivables.

4.136 There is no information readily available on the total cost or value of the government's assets. However, current estimates of the value of real property alone range between $40 billion and $60 billion.

4.137 We reviewed financial controls over assets in the five departments in our study where assets are an important part of program delivery. Several of the departments have problems with these financial controls. In Energy, Mines and Resources we found that asset management systems and practices do not provide assurance that equipment assets are controlled adequately and safeguarded properly and that their use is monitored. In the Department of Agriculture, systems provide some degree of assurance for the safeguarding of assets, but there are deficiencies, including the fact that there is no control to ensure that all equipment acquired is recorded.

4.138 A common problem is poor financial information. At lower levels in departments, most operational managers have some records of physical quantities and location of assets. But financial records are fragmented and are often incomplete and inaccurate. A basic component of internal control is the periodic comparison of accounting records with assets to determine whether all recorded assets exist and whether all existing assets are properly recorded. The lack of good financial records of government assets renders such comparisons difficult. This lack of information has also led to problems in the management of assets as we reported earlier.

Cost Effectiveness of Financial Control

4.139 An important requirement of financial control systems is that controls be cost-effective. Different control procedures and techniques can be used to achieve the same control objective; the selection of a particular control mechanism should be made on the basis of its cost effectiveness.

4.140 The environment for financial control is changing continually. For example, there have been major changes in information systems technology over the last 10 years that might have significant effects on available control procedures and techniques. Given the large amount of money spent on financial control annually, it is imperative that the cost effectiveness of control systems be assessed regularly.

4.141 The Office of the Comptroller General is now examining the cost effectiveness of existing controls in the areas of payment processing and authorization of transactions. This is a welcome initiative with potential for cost savings.

4.142 The federal government processes some 140 million payment requisitions annually. In a recent study, the Office of the Comptroller General estimated the direct personnel costs associated with requisitioning these payments to be in the range of $300 million. The Comptroller General's Office is now proposing different control techniques that would reduce these costs while still providing adequate control. This initiative could be extended to a wide range of control activities in the federal government.

4.143 **Departments should correct the internal control weaknesses that have been identified. In particular, they should ensure that the assets they are responsible for are adequately safeguarded. The Office of the Comptroller General should issue guidelines and directives for introducing cost effective control techniques wherever possible.**

Financial Management Information Systems

4.144 Financial management information that is accurate, reliable and available at appropriate times is essential for good financial management and control.

4.145 In 1975 we found the financial reports provided to departments by the Department of Supply and Services were of inadequate quality and were not timely. Departmental reporting systems were used to control cash but were of little value for managing operations.

4.146 Throughout this chapter we have discussed the quality of information available to managers to allow them to carry out their responsibilities for financial management and control. We have found that there is more information than ever before but that often it is not better information. Because of the importance of information, we paid particular attention to the way automated financial management systems were developed in the departments we reviewed.

4.147 Building good information systems is one of the main ways of ensuring that appropriate financial management information is available within departments. With today's technology, information systems can capture large amounts of data yet be made powerful and flexible enough to respond quickly to managers' needs. Most successful organizations today recognize the strategic importance of information technology. They use it to reduce costs, to develop innovative ways of doing business and to supply vital information to management.

4.148 The Government of Canada spends approximately $1 billion a year on computer systems. The Office of the Comptroller General has estimated that expenditures on financial systems account for approximately $300 million a year. Over the past decade there has been a substantial investment in computerized financial systems. During our audits of departments, we reviewed a number of these investments.

We were not encouraged by what we found in our audit of departments' computerized financial systems. In many cases there was a pattern of project failures, cost overruns, poor operating performance, duplication of effort and significant waste.

4.149 Major financial systems development projects have taken years to implement. They have almost never come in on time or within budget. Decisions to proceed with systems are often made on the basis of incomplete estimates that are then ignored as systems are implemented. Project management in the systems we observed was deficient. Departments rarely keep track of full project costs.

4.150 The future holds significant risk. Many of the systems we saw, which involved great effort and cost over the past 10 years, have failed to meet the needs of users. Some have already been abandoned and replaced, and plans are now being put forward to replace several others.

4.151 As we noted earlier, managers are not receiving from automated systems the information they need to manage their operations. Important financial information is missing in most of the departments we evaluated. The departments identified many of these needs as far back as 1979. They include information on fixed assets, multi-year projects and commitments, revenues, costs of programs and activities, person-year use and the operation of facilities.

4.152 Most of the existing financial systems do not contain timely information except for allotment and commitment control purposes, and there is little likelihood that the replacement systems now contemplated will change this significantly.

4.153 Duplication of effort is commonplace. Electronic interchange of data has been possible for several years, but many departments enter information twice, once in their own system and again in the Department of Supply and Services system. A net annual saving of 10 person-years could be achieved by transferring data direct from the Department of Employment and Immigration system to the Department of Supply and Services system. The two departments started negotiating in 1981. In addition, most departments have duplication between their formal departmental systems and informal 'black book' systems.

4.154 We found that it is common for systems to be five to eight years in the building process. But users' information needs are not static; nor is technology. This means that changes to specifications have to be implemented continually throughout the life of a project. As any manager will realize, this is a sure recipe for losing control of costs.

4.155 The Clientele Profile System (CPS) in Customs and Excise shows the risks associated with long implementation periods. It has been in development for seven years, has cost approximately $10 million, and is now only in the pilot stage. In the meantime, an interim system had to be put in place at a cost of $1.1 million. Further, the Department will have to convert the systems that CPS is intended to replace at an estimated cost of $1.5 million. The project is on hold.

4.156 In their proposals to Treasury Board for funding information systems, departments often did not do a complete evaluation to identify and provide information on all costs. Some departments considered only the cost of purchasing a software package and hiring contractors to customize it. Others included internal personnel costs as well as training. The result was that inconsistent and often incomplete information was provided to those approving the acquisition. At present, four departments in our sample are proposing to install financial systems based on the same software, customizing it to suit their particular needs. We found a wide disparity in the quality and completeness of their proposals. For example, the submission of the Department of Agriculture was complete and informative. The others were not. The four cost estimates for introducing the system range from $500,000 to $4.8 million.

4.157 Once approval was given to proceed with developing a system, it was rarely done with due regard to economy and efficiency. Major systems development projects seldom came in on time or within budget. Project management was deficient in most systems development efforts, and total costs were rarely tracked. Typically, we found that there were several project managers over the life of a project. No project budget was established, and there was no mechanism to report on continuing costs and variances. This lack of a disciplined approach has led to the major cost overruns identified in Exhibit 4.9.

4.158 The development of the materiel management system at Transport Canada provides an example of serious deficiencies in financial systems development (Chapter 13). The project started out modestly and was to be completed in two years. More than six years

Exhibit 4.9

EXAMPLES OF FINANCIAL SYSTEMS DEVELOPMENT

Department/System	Initiated	Estimated Cost ($ 000)	Recorded Cost ($ 000)	Current Status
CUSTOMS AND EXCISE				
Clientele Profile System	1979	608	7,300	Pilot operating in one region. Further development on hold. Costs caused by delay expected to reach an additional $2.7 million
Financial Expenditure Control System	1981	no estimates at time of approval	1,200	Partially implemented. Not linked to Central Accounting System, thus data entered twice.
TRANSPORT				
Transport Canada Materiel Management System	1981	821 then revised to 3,800	8,000	Annual operating costs of $3 million, controls inventory worth $40 million with annual turnover of $20 million.
Personnel Management Information System	1981	1,300	5,300	System still incomplete
National Accounts Receivable System	1981	260	800	Provides information primarily for headquarters management; regional managers keep separate systems.
Billing and Cash Reporting Systems	1981	N/A	625	Systems cancelled, replacements being considered.
SUPPLY AND SERVICES				
Salary/Service Database	1978	150	800	Implemented in 1985, information deemed unreliable. Clerks continue to keep manual system.
VETERANS AFFAIRS				
Veterans Affairs Benefit Delivery Systems	1978	2,300	21,500	Several major objectives not met. Costs $6 million annually to operate.

later it has cost considerably more than originally planned and has had to be redesigned to meet a changing computer environment. Project management was weak. There were four project managers during the first four years of the project. No formal project budget was established at the outset. Costs were not formally reported and variances were not controlled at the project level. The development and operating costs of this system far exceed the benefits initially estimated by the Department. Transport Canada states that by the end of 1988, when all inventories will be included in the system, there is a reasonable expectation that benefits will outweigh the development costs.

4.159 Apart from cost overruns, there are costs associated with lost opportunities or lost savings. For example, in Chapter 11 we report on the attempts of the Department of Supply and Services to build a pay history system to support pension calculations for public service employees. The system, begun in 1978, was intended to replace the thousands of ledger cards maintained manually to keep track of the earnings histories of employees eligible for pension benefits. The system was expected to cost less than $150,000. Today, nine years later, and after having spent $800,000 on the system, the Department has been unsuccessful in developing a working system containing data accurate enough to be used. As a result, clerks continue to maintain manual pay history ledger cards.

4.160 Once the decision is made to proceed with systems development, departments sometimes acquire hardware and software without sufficient risk analysis, with inadequate planning and very often without complete specifications. This has led to various problems such as bad choices of hardware and software, insufficient or excessive computing power, and incompatibility with other departmental systems. For example, in the Department of Agriculture a corporate financial information system was introduced in 1984 to run on hardware that is no longer available or supported and that quickly proved inadequate to meet the demands put on it. And so managers maintain independent accounting systems to get the information they need. A replacement for the existing system is planned, at an estimated cost of $4.8 million.

4.161 The Treasury Board is proposing to issue additional guidelines for systems development to departments. These are designed to address a number of the concerns we have raised.

4.162 Departments should adopt appropriate systems development management processes and enforce them rigorously.

4.163 Systems development should be pursued through relatively small project stages with short timeframes, clearly defined objectives and detailed budgets.

4.164 All systems development costs should be recorded and compared to systems development budgets on a year-to-date and on a cumulative basis to provide an accurate record of total costs.

4.165 Departments should use appropriate project management techniques to monitor developments and track benefits on a regular basis.

Role of the Financial Function

4.166 Financial management and control is part of general management and therefore the responsibility of line managers. But financial officers also have a special role to play in ensuring that managers have the necessary tools and information to carry out their financial responsibilities.

4.167 In 1976, we viewed the position of the senior financial officer in departments as fundamental for the effective and efficient management and control of public funds. In organizational terms we stated that the senior financial officer in each department should be a member of top management. But more important, we believed that this person

> should have the breadth of vision to fully comprehend the content and significance of existing policies and new policy proposals, combined with the financial expertise and experience necessary for rendering constructive advice to the deputy head and fellow members of the top management group on how to make effective use of the appropriate financial management techniques in administering departmental programs.

4.168 All departments in our sample have designated a senior financial officer responsible for the financial function. This individual is usually an assistant deputy minister and is always a member of the departmental executive committee. Most senior financial officers have additional responsibilities besides finance. Our review concentrated on the functions performed by those financial officers working under the direct authority of the senior financial officer in each department.

In most departments, the authority and responsibility of the senior financial officer and of the financial function are defined in the department's financial manual. Their responsibilities in the area of financial control are, on the whole, well accepted and well carried out. But in many instances the financial function does not perform the functional and advisory role specified in its mandate.

4.169 The Treasury Board Guide on Financial Administration clearly describes departmental responsibilities for financial administration and assigns many of them directly to financial officers. Others are shared with program managers.

4.170 We found that the roles and mandates, and therefore the effectiveness, of senior financial officers and of the financial function are not consistent from department to department. Instead they are determined by the nature and history of each department and by the attitudes and personalities of the people involved.

4.171 The Guide on Financial Administration states that the financial function is responsible for financial systems and controls. Part of this is the design and operation of accounting and internal control systems. These systems ensure that appropriations and allotment limits are not exceeded, that accurate records are kept, and that existing regulations and central agency directives for control of expenditures, revenues and assets are followed. We found that the financial function in all departments ensures that accounting data are accurate and reliable, that money is spent for the purposes intended and that spending does not exceed the approved levels. All the departments have developed financial manuals defining the various financial responsibilities, policies, systems and procedures. Internal control has been the major focus of financial officers and, as we reported earlier, they have succeeded in establishing basic financial controls in their departments.

4.172 The second part of the responsibilities of the financial function is the design of financial systems to provide managers with financial reports that are simple, timely, accurate and consistent and that meet their needs for financial information. As we commented earlier, managers usually have confidence only in the information they receive on allotment and commitment control. Where financial officers have responsibility for financial systems these are usually limited to expenditure control systems. They either do not have or do not see themselves as having responsibility for performance measurement systems whose information could be integrated with financial data for management purposes.

4.173 Financial officers should also identify the need for cost information and recommend and implement techniques to generate it. Few departments have good cost information, a factor that limits the financial officer's role in budget preparation to providing instructions and reviewing them for form.

4.174 Operational managers are responsible for providing analyses of variances between actual and budgeted figures. It is at this point that financial and operational data should be combined to analyse the efficiency of operations and the effect of factors such as volume on operations and costs. Financial officers should assist operational managers in doing this. This rarely happens. Just as operational data and financial data come from two different sources and are seldom integrated, financial officers and operational managers tend to function separately.

4.175 Senior financial officers, as members of departmental executive committees, usually participate in decisions. Their primary role is to consider the financial implications of those decisions. But without the relevant information on costs and operational indicators, their contribution to the decision-making process can be only marginal. Where the financial group has responsibility for pulling together both operational and financial data, such as in Employment and Immigration Canada, the challenge role becomes much more meaningful.

4.176 Because of this communication gap between program and financial officers, we looked at the training provided in the financial area to both these groups. A review of the courses offered by the Public Service Commission to the financial community and to program managers with financial responsibilities led to these conclusions:

There are significant gaps in current course offerings as they relate to financial responsibilities. Until recently there has been little attempt to ensure that the financial content of courses for financial officers is up to date and appropriate to the needs of participants. General management courses tend to have little financial content.

4.177 Exhibit 4.10 shows the time allocated to financial matters in various courses as well the number of participants over the past four years. The course content tends to focus on government processes and systems. Many of the courses were taken by clerical and administrative staff and by new program managers. Some individuals attended more than one of the courses.

4.178 There are approximately 2.500 public servants classified as financial officers. Although there have been major changes in financial management systems and procedures since 1983, many financial officers have not had formal training in these areas.

4.179 The Office of the Comptroller General has recently completed an occupational analysis of the financial community to ascertain its training needs. As a result, Public Service Commission courses are being changed to reflect these needs.

4.180 To conclude, financial control has improved greatly over the last decade, and the financial function has played a major role in this improvement. The financial function ensures that accurate financial data and adequate financial controls exist in most areas and that managers have the necessary information to ensure that money is spent for the purposes intended without exceeding the approved levels.

4.181 But the role the financial function has been able to play in financial management has been limited. Because they do not have information that integrates operational and financial data, financial officers have generally not succeeded in providing information that is useful to program managers for purposes other than controlling spending. This also limits their ability to offer effective challenges to spending plans. Because the roles of the financial officer and the program manager in financial management are not clear, the financial function does not provide the necessary direction and guidance to promote the use of measures of economy, efficiency and effectiveness.

4.182 Departments should review the mandates of the financial officers to ensure they are clear and that the current responsibilities of these officers reflect these mandates. Responsibility for integrating financial and operational data should be clearly defined.

4.183 Courses for program officers should be reviewed to ensure that the financial content is sufficient to provide them with a clear understanding of their responsibilities in this area.

Exhibit 4.10

FINANCIAL COURSES AVAILABILITY AND USAGE

Course	Level	Financial Content	No. of Students*	Courses Given*
Orientation	ADM	5%	193	10
	EX	8%	1,905	60
	SM	15%	2,124	69
	Type	**Duration**		
Financial Management	General	5 days	130	6
	I	3 days	1,539	75
	II	9 days	629	32
	Budgeting	4 days	603	38
	Planning	5 days	176	10
	Analysis	4 days	271	9

* 1983-84 to 1986-87 Fiscal Years

Role of the Agencies of the Treasury Board

4.184 As we have reported throughout this chapter, serious weaknesses remain in financial management. Many of them are specific to one department or another. There is a need for management in the departments concerned to take the steps necessary to correct these shortcomings.

4.185 Other weaknesses are common to almost all departments. Many of these problems would not have occurred or would have been greatly reduced if central guidelines had been followed or if central agencies were doing what is stated in their mandates. Why is this not happening? We thought we could throw light on the question by examining certain basic areas that central agencies must deal with.

4.186 We began by examining the role that Treasury Board states its agencies should play. According to the Part III of the Estimates of the Treasury Board Secretariat, the Treasury Board is the general manager and employer of the public service. This responsibility has been assigned to it under the Financial Administration Act.

4.187 With respect to the management of the government's financial resources, sections 5(1)(c) and (d) of the Act give the Treasury Board the power to act on all matters relating to:

- financial management, including estimates, expenditures, financial commitments, accounts, fees or charges for the provision of services or the use of facilities, rentals, licences, leases, revenues from the disposition of property, and procedures by which departments manage, record and account for revenues received or receivable from any source whatever; and
- the review of annual and longer term expenditure plans and programs of the various departments of Government, and the determination of priorities with respect thereto.

4.188 To carry out its legal mandate, the Treasury Board has been granted wide powers. These include making regulations as well as the right to require "any account, return, statement, document, report or information that the Board considers necessary for the due performance of its duties".

4.189 Two organizations serve the Treasury Board – the Treasury Board Secretariat and the Office of the Comptroller General. The Secretariat is responsible for recommending and advising Treasury Board on policies, directives, regulations and program expenditure proposals with respect to the management of the government's financial, human and materiel resources. The Office of the Comptroller General is responsible for developing and implementing sound management practices in the federal government.

4.190 The Treasury Board Secretariat is the administrative arm of the Treasury Board. Its objective is "to support the Treasury Board in performing its statutory responsibilities for the management of government's financial, human and materiel resources". In the area of financial management, according to Part III of the Estimates, the Secretariat analyses departmental plans and programs and recommends the acceptance or modification of specific expenditure proposals, in order to:

- "reflect the priorities which the government assigns to the objectives;
- increase the effectiveness of existing and proposed programs;
- the efficiency with which the person-year resources, facilities, equipment, materials and supplies are used in the operation of programs".

4.191 In the area of information management, it "develops, interprets and performs compliance monitoring of all policy on information management. This includes the management of information technology".

4.192 The Comptroller General's Office states that its objective is

> to see to the establishment and maintenance of sound management practices in the federal government by developing policies and standards for financial and operational planning, reporting and controls, and by promoting and monitoring improvements in the practice of financial and operational management in departments and agencies.

4.193 The Comptroller General's Office is concerned with legislation, policies, directives and standards governing financial control, accounting, cash management, and financial management systems. It is concerned with the standards governing the form and content of the Estimates and the Public Accounts. It provides advice, information and research on all aspects of human resource management for the financial community. The Office of the Comptroller General also promotes the use of departmental internal audit and program evaluation functions, provides advice and assistance to departments in addressing identified deficiencies, and monitors and reports on the state of processes and systems across government.

4.194 The problems we identified that were common to most departments fall under three areas of these two agencies' responsibilities.

Resource Allocation

4.195 An important consideration for the current resource allocation system is the Operational Plan Framework. Each department presents its annual proposal for the funding of its programs through a Multi-year Operational Plan based on the structure set out in the Operational Plan Framework. But as we noted earlier, few of these plans contain meaningful results statements or a clear indication of the relationship between objectives, resources and results at the level of aggregation required for review by Treasury Board.

4.196 We recognize that for purely practical reasons resources have to be allocated from the centre under quite a limited number of headings. There is a limit to the number of allocation categories to which Treasury Board Ministers can be expected to give even cursory consideration. But results in quantitative or qualitative terms can be measured only at the level of operations, and there are many thousand operational activities in government. These thousands of operational units are aggregated into programs for resource allocation purposes. As we reported earlier, because these units are often so diverse, effectiveness and efficiency measures could not be aggregated in a meaningful way, even if they existed in all units.

4.197 Efficiency measures rarely exist, even at lower levels in departments, and few are linked to financial requirements. The information that is provided to the Treasury Board has usually been aggregated to a level where it is no longer meaningful.

4.198 Central information for analysis purposes is difficult to obtain. As we reported earlier, departments do not have good financial management information. The situation is worse at the centre, which must rely on the Central Accounting System of the Department of Supply and Services or on reports received from departments. The Central Accounting System was designed to produce financial data for Public Accounts purposes and was not designed as a management tool. Information provided by departments is often not consistent from one to the other and therefore not comparable. The Office of the Comptroller General has recognized these problems and this year surveyed central users of information to ascertain what is missing. It is now proposing an action plan to address these shortcomings.

4.199 We recognize that resource allocation decisions will never be made in a totally objective manner. Socio-economic considerations will always influence decisions. Nevertheless, the following questions need to be answered:

> **How can resources be allocated rationally if the underlying mechanisms are not providing reliable information on the efficiency and effectiveness of operations? Is the level of aggregation asked for by the current resource allocation system meaningful or necessary?**

Financial Management Information Systems

4.200 In our 1983 chapter on the management of computing, we recommended that the Treasury Board review, clarify and, as necessary, strengthen its role in the management of information technology. We stated that if the Board did not wish to take a leading role, it should have quickly made known to departments what areas were to be left to their initiative and where departmental action was most urgently required.

4.201 Treasury Board acknowledged it had a leadership role to play and appointed a Task Force on Informatics. Nevertheless, the problems we identified earlier in this chapter were the same as those that had been identified in 1983.

4.202 Chapter 440 of the Administrative Policy Manual has remained unchanged since 1980. It states that the Administrative Policy Branch

> is responsible for developing, revising, and interpreting policies and guidelines for EDP planning, procurement, operations and evaluation, and for reviewing and recommending action on departmental plans and related submissions. The branch also monitors the progress of government EDP, including participation in reviews of projects and assessments of the level of service of particular operations, and ensures the sharing of information relating to EDP within the federal public service.

4.203 Despite this statement of responsibility, there is little indication that the Secretariat monitors that departments deliver financial systems development projects on time or within budget. As we indicated earlier, once a system is approved, costs can increase substantially without the Secretariat being aware of the fact. The only warning mechanism that seems to exist is when additional funds are required to complete an installation.

4.204 In our opinion, the present monitoring and control process for financial information systems does not work.

4.205 This question needs to be answered:

> **Who is accountable for delivering financial information systems - central agencies or departments? What should be the role of the Treasury Board Secretariat and the Office of the Comptroller General in the process?**

Management Practices

4.206 Both the Office of the Comptroller General and the Treasury Board Secretariat have issued a series of guidelines and directives over the past decade. The Office of the Comptroller General has also been responsible for ensuring that internal audit and program evaluation units exist in departments.

4.207 The central agencies have been successful in the area of financial control. Financial officers in departments have set up the necessary control mechanisms, and these are monitored regularly by the internal audit groups in departments.

4.208 The central agencies have been much less successful in promoting efficiency and effectiveness in operations. The policy on efficiency measures has not changed since 1976. There has been no concerted attempt to ensure that these exist in operations that lend themselves to such measures. The Office of the Comptroller General has concentrated instead on performance measures at the aggregate level for inclusion in Operational Plan Frameworks or for reporting in Part III of the Estimates.

4.209 These are not the measures with which departments manage. Central agencies have concentrated on developing systems and procedures for their own purposes without sufficient regard to the needs of departments in managing their own operations. Without clear direction from the centre about the importance of knowing the efficiency of all levels of operations, departments have struggled to fulfil central requirements while developing other systems to meet their needs or, worse still, failing to develop an appropriate system at all.

4.210 We reported earlier in the chapter the problems we identified in departments in the areas of planning and reporting. The guidelines from the centre are clear. But there is little indication that the central agencies knew about the problems or, if they did, that they recommended or initiated corrective action. There is no accountability mechanism in existence, although the Increased Ministerial Authority and Accountability initiative is intended to fill this gap.

4.211 This leads to the following questions:

> **What is the dividing line between "letting the managers manage" and ensuring that departments are being managed so as to meet the objectives set by government?**
>
> **What mechanisms exist at the centre to detect problems in departments?**
>
> **What can and should be done when problems are identified?**

4.212 In summary, our study found major improvements in financial control in government. We are encouraged by the progress made by a number of departments, particularly in the past two years. But financial management is not yet satisfactory. There is a need for both department managers and central agencies to ensure that information is available to understand the financial implications of decisions, to ensure that operations are carried out with due regard for economy, efficiency and effectiveness, and to ensure that both information and mechanisms for financial accountability exist and are being used.

REVENUE CANADA - CUSTOMS AND EXCISE

REVENUE CANADA - CUSTOMS AND EXCISE

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REVENUE CANADA - CUSTOMS AND EXCISE

Introduction

5.1 Revenue Canada - Customs and Excise plays an important role in implementing the Government's socio-economic policies. On the Customs side, as well as collecting duties and taxes, the Department plays a front-line role in the fight against narcotics smuggling, blocking entry to terrorists, preventing illegal immigration and the entry of pornography. Excise collects taxes and duties from licensed manufacturers and wholesalers, distillers, brewers, and tobacco manufacturers. In the area of economic policy, the Department is involved in implementing Canada's multilateral trade agreements.

5.2 The Department of National Revenue has two components – Taxation, and Customs and Excise. Both operate as independent departments reporting to the Minister of National Revenue. Each has its own Deputy Minister. In this chapter "Department" or "Customs and Excise" or "Revenue Canada - Customs and Excise" refers to the Department of National Revenue - Customs and Excise.

Objective of Customs and Excise:

Collects revenue
Controls movement into and out of Canada
Protects Canadian industry

5.3 The Customs and Excise objective as stated in Part III of the Estimates is threefold:

- to ensure that all duties, taxes and other relevant charges and levies are assessed, collected and where appropriate, refunded;
- to control, for the protection of Canadian industry and society, the movement of people, goods and conveyances entering or leaving Canada as required to achieve compliance with legislation; and
- to protect Canadian industry from real or potential injury caused by the actual or contemplated importation of dumped or subsidized goods, as well as by other forms of unfair foreign competition.

5.4 The Department operates on the principle that the majority of the public voluntarily complies with the laws that Customs and Excise administers, especially when the public is clearly informed about those laws. This enables Customs and Excise to concentrate on selective enforcement against the small percentage of the public that tries to evade the law.

5.5 Customs and Excise is organized into three activities: Customs, Excise, and Corporate Administration. Customs administers the Customs Act, the Customs Tariff, the Special Import Measures Act, the Customs and Excise Offshore Application Act, and the Duties Relief Act. It deals mainly with Canadian and international travellers, Canadian manufacturers and importers and exporters. Included in this activity is the administration of hundreds of Orders in Council that grant remission of duties and/or taxes. Excise administers the Excise Act and Excise Tax Act and is primarily concerned with collecting sales and excise taxes on domestic and imported goods, excise duties on spirits and tobacco, and taxes on energy products. It also deals with licensing manufacturers and wholesalers and regulatory control of distilleries and breweries. Corporate Administration includes the central administrative and functional services necessary to support the Customs and Excise activities.

5.6 In addition, Customs and Excise administers, in part, close to 70 pieces of legislation on behalf of other departments, including the Department of Agriculture, Health and Welfare Canada, Department of Consumer and Corporate Affairs, Department of Regional Industrial Expansion, Statistics Canada and Canada Employment and Immigration Commission.

Financial Data

5.7 Revenue collection is an important responsibility of the Department. A breakdown of the tax revenue collected by Customs and Excise for 1984-85 to 1986-87 is illustrated in Exhibit 5.1. The Public Accounts show that in 1985-86 approximately $1 billion in remissions were granted.

5.8 In 1985-86, the Department used 10,210 person years and spent $415 million. Approximately 85 per cent of these expenditures in 1985-86 were personnel related and 15 per cent were for operating and capital costs. A significant portion was used to control the movement of people, goods and conveyances entering Canada and to protect Canadian industry.

Environment

5.9 There are many challenges facing departmental management. The past two years have brought significant changes to some of the legislation that Customs and Excise administers. A new Customs Act was proclaimed in 1986 replacing a 118-year-old statute. It is expected to speed up the processing of imported goods through Customs and reduce the administrative paper burden on both the government and the business community. A new Duties Relief Act brought changes to the legislative base for tariff relief. Successive budgets, ways and means motions, tax reform, amendments to the Excise Act and the Excise Tax Act, and the Fuel Tax Rebate program are some of the legislative factors that have shaped Excise's operating environment.

5.10 The Department is making changes to many of its processes to enable it to respond to rapidly changing developments in transportation, communications and data information technology. For example, the Department expects to implement a new automated Customs Commercial System in 1988 that will enable qualified importers to clear imports quickly based on minimum documentation.

Exhibit 5.1

REVENUE CANADA – CUSTOMS AND EXCISE
MAJOR TAX REVENUE SOURCES
(in billions of dollars)

	1986-87	1985-86	1984-85
Sales Tax	12.0	9.4	7.7
Customs Import Duties	4.2	4.0	3.8
Excise Duties	1.4	1.5	1.5
Other Excise Taxes and Duties	1.5	1.3	.8
Excise Tax - Gasoline	1.5	.7	.4
Total Net Tax Revenue	20.6	16.9	14.2

5.11 At the time of our audit several initiatives were under way that have, or could have, a significant impact on Customs and Excise. These include the Softwood Lumber Levy, initiatives to fight illegal use of drugs, proposed legislation on pornography, new rules governing immigration, and free trade negotiations. Sales tax changes were also proposed in the White Paper on Tax Reform dated 18 June 1987.

5.12 In response to the Government's decision to reduce its person-years and expenditures, the Department has developed a Person-year and Cost Reduction Plan to reduce its staff by 954 person-years by 1990-91.

Financial Management and Control Study

5.13 A government-wide Financial Management and Control Study was done by our Office between 1974 and 1976. Since then the government has committed significant resources to improving financial management and controls, including the creation of the Office of the Comptroller General, the introduction of the Policy and Expenditure Management System, and the introduction of Part III of the Estimates. The financial environment in which the government operates has also changed. The government faces large deficits and restraint has become a government theme. In this environment good financial management and control are particularly important.

5.14 Since 1975 the Department has made many improvements in financial management and control particularly in response to government-wide initiatives. These include forming a Corporate Management Branch, establishing a Priorities Committee, developing a Management Improvement Plan, developing an Operational Plan Framework, developing Part III of the Estimates, establishing a program evaluation function, reorganizing and improving the internal audit function, developing a performance measurement system, establishing an accountability contracting process, and streamlining and improving planning and management reporting systems. Customs and Excise was the first department to sign a

Memorandum of Understanding with the Treasury Board under the Increased Ministerial Authority and Accountability initiative. This was done on 5 June 1987.

Audit Scope

We reviewed the following areas:

Financial management and control
Financial management information systems
Remission programs

5.15 Customs and Excise was part of the government-wide study of financial management and control reported in Chapter 4.

5.16 As part of our departmental financial management and control audit, we documented, evaluated and tested the revenue systems in place during 1986-87. We did this to determine whether the approximately $20.6 billion received by Customs and Excise as revenue was adequately safeguarded and properly accounted for.

5.17 We reviewed the Department's planning systems and the budgeting systems in the Excise Branch. In conjunction with this work, we examined the Memorandum of Understanding between the Department and the Treasury Board. Reporting documents prepared at a corporate level for senior management, central agencies and Parliament were also examined. Our review of the planning, budgeting and reporting systems was done to determine whether the Department adequately plans the use of its resources and can be held accountable for the achievement of results. We included a review of the financial function to determine the way in which it was performing its role with respect to financial management and control and, in particular, with regard to the advice and assistance provided in relation to initiatives. We also reviewed the internal audit function to determine whether it conformed with the internal audit standards issued by the Office of the Comptroller General.

5.18 We examined two departmental financial information systems – the Clientele Profile System and the Financial Expenditure Control System – to determine whether systems development activities were carried out with due regard to economy and efficiency and resulted in useful financial management information.

5.19 The remission programs administered by the Department either provide tariff relief to importers and Canadian industry or facilitate the international movement of goods and equipment. Our review of the financial management of these programs was done in a similar way to that used to review direct expenditure programs. This included the information provided to Parliament about remission programs, whether satisfactory procedures had been established to measure and report the effectiveness of remission programs, and the compliance with authorities for remission programs.

Financial Control

5.20 Financial control means that assets owned by the government should be properly recorded and protected, and accounting data should be accurate and reliable. Funds should be spent only for those purposes stated and within the limits approved by Parliament. In Customs and Excise the major assets are cash and accounts receivable. Customs and Excise has systems in place to assess, collect and account for revenue and to process the millions of documents received annually. These systems were designed to facilitate the voluntary compliance of importers and taxpayers with various revenue laws and regulations.

Tax Revenue

5.21 As part of our audit, we documented, evaluated and tested revenue systems to determine whether revenue collected was safeguarded and properly accounted for. Our audit did not include enforcement activities such as taxpayer audit, nor did it include an assessment of the "revenue gap". The revenue gap represents the difference between the amount of money that should be collected, assuming 100 per cent compliance with the law, and that which is actually collected.

Financial controls over revenue are adequate.

5.22 We concluded that for the fiscal year 1986-87, in all significant respects and in accordance with the Financial Administration Act and other relevant legislation:

- there was an adequate system of internal control to give reasonable assurance that moneys received were recorded and deposited;
- moneys received were properly allocated and accounted for in accordance with the stated accounting policies of the Government of Canada and on a basis consistent with that of the preceding year; and
- client accounts maintained by the Excise Branch for various taxes and duties were properly stated and reflected remittances and assessments.

Expenditures

5.23 In 1985-86 Customs and Excise spent approximately $415 million. We observed no instances where any of these funds were spent for purposes other than those authorized. We reviewed the Department's use of appropriations from 1983-84 to 1985-86. The Department limited its spending to those levels approved by Parliament.

Financial Management

5.24 Part of the theory of financial management in government includes the concept that funds are voted on and managed on the basis of a plan, and then their use is reported against that plan. Managers should use these funds to manage operations economically, efficiently and effectively and be able to provide an accounting of what they accomplished with the money entrusted to them.

Planning and Budgeting

5.25 To implement the concepts of financial management, the government designed a planning system called the Policy and Expenditure Management System (PEMS). Under PEMS each department must produce an Operational Plan Framework. In Chapter 4, the Operational Plan Framework is discussed in paragraphs 4.74 to 4.80. The key terms of the Operational Plan Framework are explained in Exhibit 5.2. Operational Plan Frameworks are designed to be the basic structures for presenting programs for resource allocation and accountability purposes. They are intended to provide the framework within which departments manage resources and eventually report results to Parliament through Part III of the Estimates. Operational Plan Frameworks should define what the department plans to accomplish and describe the linkage between resource levels and results and the linkage between results and objectives. Part of the Customs and Excise Operational Plan Framework is illustrated in Exhibit 5.3.

Customs and Excise has made progress in developing and implementing the government-wide planning framework. But improvements are needed.

5.26 In Chapter 4 we concluded on a government-wide basis that Operational Plan Frameworks, in their present state of development, are not useful tools for making objective decisions about resource allocation and do not provide an adequate basis for accountability. Chapter 4 sets out several reasons for the failings of Operational Plan Frameworks. In summary: program objectives are often broad and imprecise; it is difficult to translate these objectives into clear, measurable results statements; and performance indicators at operational levels can rarely be related to program objectives. For this reason, we recommend in Chapter 4 that the Treasury Board should re-examine the Operational Plan Frameworks. This would involve the Treasury Board working with departments to resolve these failings.

5.27 Despite the inherent weaknesses in Operational Plan Frameworks, we found that Customs and Excise has made progress in developing and implementing its Operational Plan Framework. This has resulted in a clearer definition of the activities carried out by the Department and a clearer articulation of the broad intent of these activities. However, there are still areas where Customs and Excise can make improvements within the requirements prescribed by the Treasury Board. Overall, the Customs and Excise Operational Plan Framework does not provide a complete accountability framework for the Department to plan, manage and account for the efficient and effective use of its resources to achieve results and objectives.

5.28 The Operational Plan Framework does not directly address the issue of the "revenue gap" which, as noted previously, represents the difference between the revenue that should have been collected and that which was actually collected. One of the Department's

Exhibit 5.2

OPERATIONAL PLAN FRAMEWORK EXPLANATION OF KEY TERMS

OBJECTIVES are clear statements of why an activity is being carried out.

RESULTS STATEMENTS are statements of

(a) outcomes (what is to be achieved)
(b) outputs (goods or services performed)

LINKAGE STATEMENTS are statements of

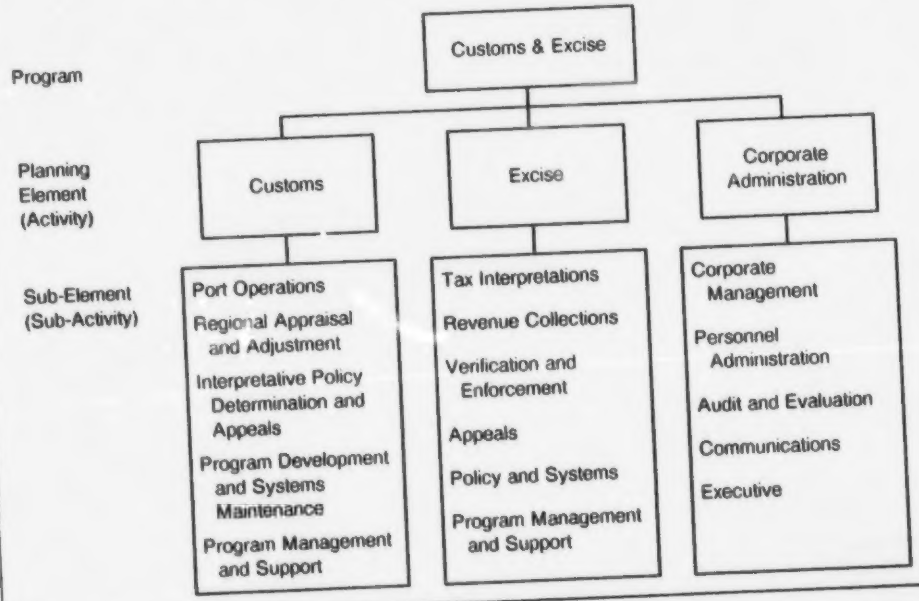
(a) how results help meet objectives
(b) the relationship between the level of resources and expected results

PERFORMANCE INDICATORS are

(a) effectiveness measures (how outcomes would be measured)
(b) efficiency measures (the relationship of people and dollars to outputs)

Exhibit 5.3

REVENUE CANADA – CUSTOMS AND EXCISE OPERATIONAL PLAN FRAMEWORK COMPONENTS


Program
Customs & Excise
Planning Element (Activity)
Customs
Excise
Corporate Administration
Sub-Element (Sub-Activity)
Port Operations
Regional Appraisal and Adjustment
Interpretative Policy Determination and Appeals
Program Development and Systems Maintenance
Program Management and Support
Tax Interpretations
Revenue Collections
Verification and Enforcement
Appeals
Policy and Systems
Program Management and Support
Corporate Management
Personnel Administration
Audit and Evaluation
Communications
Executive

responsibilities is "the collection of all duties of excise" as stated in the Department of National Revenue Act. This is reflected in part of the departmental objective which is "to ensure that all duties, taxes and other relevant charges and levies are assessed, collected and where appropriate, refunded". The measurement of the "revenue gap" would be a key effectiveness indicator to determine if this part of the objective is being met. The revenue gap is not directly addressed in the results and linkage statements or the performance indicators. While we recognize that this may be difficult, we believe that proxy measures would be useful and can be developed.

5.29 The Operational Plan Framework requires that results be stated and linked to the achievement of objectives and to the requirement for resources. At Customs and Excise we found that the statements of results are not as useful as they could be because they are not expressed in quantitative or qualitative terms or a mixture of both. They are not expressed in measures such as level of service, productivity or effectiveness indicators. This lack of indicators makes it difficult to determine whether the desired results are achieved and contribute to the program objectives.

5.30 We found that the Operational Plan Framework does not identify clear linkages between resources consumed and results achieved. It also is not clear how a change in resources would affect the achievement of results. The resources consumed in producing each result are not expressed in terms of dollars or person-years either in the resource justification documents sent to central agencies or in Part III of the Estimates. Because these are missing, it is difficult to determine whether funds have been used effectively or efficiently to achieve results.

5.31 For example, the results statement for the Tax Interpretations sub-element is:

> Eligible taxpayers are identified and licensed; licensees, refund claimants and other members of the public known to be affected by the law are provided with information and interpretations respecting their entitlements and obligations with respect to Excise legislation, policy and administrative procedures.

This statement and the statement linking it to resources are expressed in terms of one major output – written rulings issued. This indicator is incomplete because it does not address whether all the results have been achieved; that is, whether information was provided to taxpayers and whether eligible taxpayers were identified and licensed. Similarly, since the preparation of written rulings only accounts for a proportion of the person-years used in carrying out this function, the indicator cannot be used to justify the resources used.

5.32 The Department acknowledges that improvements are needed. In their Memorandum of Understanding, the Department and the Treasury Board agree that the Department needs to improve the results and linkage statements and establish measures of results in terms of level of service, productivity and effectiveness.

5.33 The weaknesses in the Operational Plan Framework carry through to the planning, budgeting and reporting processes where the same inadequate measures are used. We found that dollar and person-year levels for ongoing activities remained static;

adjustments were made for new initiatives or budget cuts. We expected periodic procedures at the departmental level, of the nature of A-base budget reviews, to examine ongoing operations. New items or initiatives are ranked in priority but there is no ranking of all existing activities to identify opportunities to make better use of the resources available.

5.34 We expected the Department to have a mechanism to hold managers accountable for achieving results and using resources economically, efficiently and effectively. Customs and Excise has developed accountability contracts, management position profiles and management performance and appraisal reports that comprise a managerial accountability process. The accountability contract is intended to outline those areas for which the manager will be held accountable. Work plans form the basis for these contracts. Managers are generally held accountable for workload targets and performance indicators identified in their work plans. The linkage of resources to these outputs is clear at this level.

5.35 But a breakdown occurs when the Department tries to aggregate these lower level targets and outputs. Indicators used in the Operational Plan Framework (that is, one major output) are not meaningful for the measurement of the statement of results. As stated earlier, there is no clear linkage between the use of resources and the achievement of results. There is still inadequate accountability by managers for the effective and efficient use of funds to produce the stated results.

5.36 **Revenue Canada - Customs and Excise should improve its results statements, linkage statements and performance indicators and incorporate these into the Operational Plan Framework and the departmental planning, budgeting and reporting processes.**

> **Department's response**: *The Department committed to improve its Operational Plan Framework in 1985 when the Treasury Board approved its implementation. The Department acknowledged then that results statements, linkage statements, and performance indicators should be improved and incorporated into its planning, budgeting and reporting processes and has been working towards this end. The Department has further formalized this commitment in its IMAA Memorandum of Understanding with the Treasury Board. Plans are underway to review the OPF jointly with the Treasury Board and to implement amendments as deemed appropriate by September 1988. The existing OPF is already fully integrated with the Department's planning and reporting systems.*

Memorandum of Understanding

5.37 The Increased Ministerial Authority and Accountability (IMAA) initiative is designed to strengthen a department's accountability, increase its flexibility to reallocate resources, increase authorities and reduce its reporting requirements to central agencies. Customs and Excise was the first department to sign a Memorandum of Understanding with the Treasury Board. This was a major endeavour by the Department to meet the challenges of IMAA. In addition, it reflects senior management commitment to work closely with the Treasury Board to improve the departmental Operational Plan Framework and performance measures. These improvements are intended to be incorporated into the planning, budgeting and reporting processes and ultimately should enable better accountability to the Treasury Board. These improvements are necessary to meet the aims of IMAA.

To meet the aims of the government initiative of increased ministerial authority and accountability, the Department and the Treasury Board must continue to work together.

5.38 The Memorandum of Understanding has allowed some flexibility in the reallocation of resources, for example, allowing the use of students year round. It has increased the Department's authorities in four areas, for example, by increasing construction project approval authority. We believe that these are only a first step in providing Customs and Excise management with greater flexibility and increased authority. This was recognized in the Memorandum. It provides for ongoing discussions between the Department and the Treasury Board.

5.39 We are concerned that the Department cannot strengthen accountability until its Operational Plan Framework has been improved. Treasury Board and the Department have agreed on September 1988 as the date for amending the Customs and Excise Operational Plan Framework – halfway through the Memorandum's three-year term. These amendments would include improved results and linkage statements and performance indicators. Until these improvements are made, there is no complete accountability framework in place.

5.40 The Treasury Board will monitor the Department's performance by meeting with departmental management and by reviewing departmental reports. At the time of our audit, the Treasury Board and Customs and Excise had not finalized reporting requirements. The preliminary reporting requirements outlined by the Treasury Board would require the Department to make available many management reports to the Treasury Board. Additionally, the Department would have to prepare an annual management report including the Deputy Minister's views about the overall performance of the Department, an explanation of significant variances from targets, proposals for change to the Memorandum of Understanding, and a summary of internal audit and program evaluation findings. We question whether this will result in the reduced reporting on management activities that is one of the aims of IMAA. Both parties have recognized in the Memorandum that further clarification and streamlining of reporting requirements are necessary, and have undertaken to do this by 30 September 1987.

Reporting

5.41 Reporting is an integral part of financial accountability. In Customs and Excise we reviewed reports prepared at a corporate level for senior management, Part III of the Estimates, and the departmental Annual Report.

The Department is taking steps to improve its reporting.

5.42 In reporting to senior management we found that reporting on expenditures was adequate and timely. The same was not true for reporting on revenue. A quarterly revenue analysis report had been discontinued. Because the Department is a major revenue collector, it needs to have adequate revenue information and analysis. The Department has informed us that the quarterly revenue analysis report will be reinstated.

5.43 The Department has made improvements to its reporting on initiatives. Reporting is timely; however, there is still no reporting to senior management of progress against each milestone. The departmental performance reporting that existed at the time of our audit was not timely or comprehensive. It did not provide the basis for the accountability document that the Department has committed itself to in its Memorandum of Understanding. Customs and Excise was aware of these weaknesses in performance reporting and was taking steps to improve them.

5.44 Part III of the Estimates for Customs and Excise provided sufficient background to give a basic understanding of the Department. But it did not adequately demonstrate the achievement of results or program effectiveness or justify the resources requested and used. The 1985-86 revenue of $18.6 billion reported in the Part III does not agree with revenue reported in the Public Accounts or the departmental Annual Report of $16.9 billion. There is no explanation or reconciliation of these numbers for the reader. There is no mention of $1 billion of remissions in the Part III.

5.45 The Department's Annual Report was produced on time and at a reasonable cost, and did not duplicate information in the Public Accounts or Part III of the Estimates.

Role of the Financial Function

5.46 Treasury Board defines the financial function as being concerned with the establishment, operation, maintenance and control of the budgetary, accounting and financial reporting systems necessary to satisfy the requirements of Parliament, central agencies and departmental management for financial visibility, accountability and control. The financial function should provide managers with reliable, complete and relevant financial information, advice, and services.

5.47 The Assistant Deputy Minister of Corporate Management Branch is the Department's senior financial officer. Although some elements of financial management are performed by line managers, our review concentrated on the functions performed by those financial officers working under the direct authority of the senior financial officer.

5.48 Since our first Financial Management and Control Study, the Department has strengthened its financial function. The Department's senior financial officer has sufficient authority and responsibility over all financial management and control functions.

5.49 As a result of our 1987 audit, we are satisfied that the financial control responsibilities being exercised by the financial function are appropriate. There are now many people with adequate educational qualifications and experience. The Department has developed detailed financial and administrative manuals defining the various financial responsibilities, policies, systems and procedures. There are appropriate internal controls over revenue.

5.50 While there was adequate financial control, the same did not apply to financial management. In this chapter, we point out a number of areas where, in our opinion, the financial function should play a stronger role in financial management. These include:

- developing better results and linkage statements in the Operational Plan Framework;
- improving performance measurement information to measure results better;
- providing better performance and resource justification information for central agencies and Parliament;
- doing better analyses of the financial implications of initiatives;
- improving financial input into systems development projects; and
- improving planning, reporting and accounting for remissions.

5.51 **Revenue Canada - Customs and Excise should ensure that the financial function plays a stronger role in financial management.**

> ***Department's response****: The Department has in place the necessary infrastructures to support sound financial management. Process improvements have been introduced and will continue to be made in order to strengthen the role played by the financial function in financial management. Some of these changes are either ongoing or planned and include: strengthening of the financial function in the branch and field operations; better performance and resource justification information; and strengthened analysis of new initiatives prior to implementation.*

5.52 **Managing initiatives.** To determine whether appropriate financial analyses were done to support management's decisions, we audited the Taxpayer Assistance Program, which is a new initiative, and 4 out of the 11 departmental cut-back initiatives accounting for 45 per cent of proposed person-year reductions in the Person-year and Cost Reduction Plan.

The quality of financial analyses to support initiatives was weak.

5.53 We found that the initiatives we reviewed were undertaken without adequate financial analyses. One of these, the Taxpayer Assistance Program (TAP), was designed to improve taxpayer compliance with existing laws and regulations. Resources for TAP came from reallocating resources within the Excise Branch to provide taxpayers with better and more timely information and easier access to experts. The Department initiated TAP after conducting a study of taxpayer attitudes and service to the public. But it did not do an adequate study of the financial implications of TAP on the revenue of the government or of the consequences of reallocating resources to this activity.

5.54 We reviewed the Postal Improvement Project and the Low Value Remission Order cut-backs. The latter consisted of two remission orders – the Postal Imports Remission Order and the Courier Imports Remission Order. Both projects were designed to reduce resources used in Customs postal operations and improve service to the public. The Postal Improvement Project releases dutiable mail immediately to addressees with an invoice of any duties and taxes owing. The Low Value Remission Order remits duties and taxes on goods imported through the mail and transported into Canada by courier services where the value for duty does not exceed $40 or where the aggregate of the duties and taxes does not exceed $5.

5.55 We found that the financial analyses of the possible impact on revenue of both cut-backs were inadequate. An attempt was made to analyse potential revenue losses, but the samples used in the calculation were limited to a few locations, were small and not statistically sound. In addition, in the case of the Low Value Remission Order, the Treasury Board submission did not attempt to project the operational and financial data to future years, and no attempt was made to segregate postal imports from courier imports although their financial impact was different.

5.56 **Revenue Canada - Customs and Excise should improve the quality of financial analyses to support initiatives.**

> **Department's response**: *The Department does in fact conduct financial analysis and evaluation of alternatives when considering new initiatives. It has in place mechanisms to ensure that such analyses are undertaken (Priorities Committee Secretariat) and continue to be improved as part of the decision-making process.*

Internal Audit

5.57 Internal audits at Customs and Excise are conducted by the Internal Audit and Evaluation Branch. We examined internal audit activities to determine whether they conformed with the internal audit standards issued by the Office of the Comptroller General. Overall, we found that there was compliance with the standards. The head of internal audit had the appropriate reporting relationship and mandate. An Audit and Evaluation Committee was functioning properly.

5.58 There are areas where improvements could be made. The long-term audit plan and the identification of the audit universe were prepared in 1983 and have not been updated. The Operational Plan Framework was implemented in 1985, but internal audit continued to plan its work using the outdated program activity structure. Consequently, although internal audit is an accountability mechanism, its work was not planned according to the departmental accountability structure. Initial efforts to redefine the audit universe started in 1985. A consultant's report is expected in 1987.

5.59 Improvements are also needed in the area of computer audits. We observed that although efforts were made to train auditors in this area and use was made of consultants and interchange staff, there were an insufficient number of computer audits done. Internal audit has not assessed the design, development, implementation and operation of systems, procedures, processes and controls of all computer-based systems. The Branch recognized these deficiencies and initiated a study in 1986 to enhance its computer auditing.

5.60 **Revenue Canada - Customs and Excise should strengthen its internal audit activities in the areas of audit planning and computer auditing.**

> ***Department's response****: The Department will continue actions currently in progress to strengthen its internal audit activities in the area of audit planning and computer auditing.*

Financial Management Information Systems

5.61 The Department is developing a number of computer systems to support its programs and to fulfil its management information needs. Once implemented, these systems will affect the manner in which most departmental activities are carried out.

5.62 We examined two departmental financial information systems – the Clientele Profile System and the Financial Expenditure Control System – to determine whether systems development activities were carried out with due regard to economy and efficiency and resulted in useful financial management information.

Computer systems were not developed with due regard for economy and efficiency.

Clientele Profile System

5.63 The Clientele Profile System involves an automated data base to provide detailed information on taxpayer clientele. The system has several functions: preparation of a taxroll data base, revenue accounting including accounts receivable and deposit systems, planning for taxpayer audits, refund information, and summarized management information. The system was intended to combine several stand-alone systems into one integrated system.

The Excise Accounting Machine System was introduced in 1983 as an interim measure at a cost of $1.1 million. The Clientele Profile System was intended to replace it (see paragraph 5.64).

After expenditures of $10 million over 7 years, the Clientele Profile System is operating in only one region (see paragraph 5.67).

5.64 The Clientele Profile System was conceived in 1979 in response to an urgent need to replace the manual accounting system. Between 1979 and 1983, $2 million was spent on studies and proposals for the conceptual design and planning of an automated system. The cost estimates in these proposals varied from $608,000 for the design, testing and implementation of an integrated data base and other EDP components, to $35 million for a fully integrated system. Although some progress was made in the planning process, an acceptable plan for developing the Clientele Profile System was not produced. Because the Clientele Profile System was not developed, an interim revenue accounting system – the Excise Accounting Machine System – had to be put into place in 1983 at a cost of $1.1 million. It is reaching obsolescence.

5.65 A Treasury Board submission was subsequently approved to develop a pilot of the Clientele Profile System by early 1985 at an estimated cost of $7.3 million. This pilot project was under development from 1984 through 1986. Part of the pilot began operating in one region in 1986.

5.66 During this seven-year period, the progress of EDP development activities was influenced by various events. First, in 1980, the Department was preparing for possible implementation of a wholesale tax. Second, in 1982, all EDP development was stopped while the Department started work on an Automated Strategy Review. The Review was issued in 1983. Third, Clientele Profile System development was suspended in 1986 pending a decision on reform of the tax system.

5.67 After expenditures of approximately $10 million over seven years, there is no integrated and efficient management information system in place to assist the Excise Branch in carrying out its regulatory functions. The Clientele Profile System has never operated on a nation-wide basis. Until such a national system is in place, the opportunity for revenue improvement of $10 million per annum, identified in the 1983 Treasury Board submission, cannot be realized. In addition, two stand-alone systems that the Clientele Profile System is intended to replace will have to be converted to a new technology. The additional cost will be about $1.5 million. Based on these facts, we conclude that the Department did not obtain value for money in the development of the Clientele Profile System.

Financial Expenditure Control System

5.68 The Financial Expenditure Control System was designed to be a comprehensive system that would provide timely and accurate information for financial planning, budgeting, allotment, commitment and cash control, analysis, and reporting of expenditures. The anticipated benefits from the system would exceed $400,000 per year. These would result from person-year reallocations and also from efficiencies because of better communication links with Supply and Services Canada.

5.69 The Financial Expenditure Control System was rated a small project by the Department. When management gave approval to develop the system in May 1981, there were no estimates of development costs or completion dates. Various studies were performed from 1981 to 1984 which together provided a definition of requirements and recommended alternatives. Anticipated costs varied from $369,000 to $1.3 million. Completion dates also varied. In 1984, the Financial Expenditure Control System was approved as a pilot with planned national implementation by April 1985. By January 1987, the system was installed nationally on a stand-alone basis and was reported as complete in the Inventory of Departmental Initiatives - Status Report. This was done although all of the system's planned features such as cash control, special writer facilities and communications facilities between headquarters, regions and Supply and Services Canada are not yet in place.

5.70 It took six years to produce this stand-alone phase of the system which is longer than would normally be expected for a microcomputer system of its size. By 1987, most of the anticipated benefits in person-year and dollar savings have not materialized. The substantial benefits identified can only be attained after the communications links are established. We concluded the Department did not develop the Financial Expenditure Control System with due regard to efficiency.

Systems development deficiencies in both systems were due to weaknesses in strategic planning and in senior management's monitoring and holding staff accountable for achieving results.

EDP Strategy

5.71 Treasury Board policy, dated December 1978, requires that departments develop a long-range EDP strategy. Customs and Excise has produced an annual Automation Strategy Review since 1983. In our opinion, the lack of an Automated Strategy Review prior to 1983 contributed to the fact that little progress was made in the development of the Clientele Profile System and the Financial Expenditure Control System. As noted previously, prior to 1983 a number of studies were done for the two systems. These studies diverged in their systems definition and development strategies.

5.72 We reviewed the documents produced from 1983 to 1987 to determine whether appropriate strategic planning was done for the automation initiatives within the Department. These strategic plans, particularly those from 1984-87, lacked a number of critical features. Applications, data, and technology plans did not tie into departmental business objectives and priorities. The impact of technological advances, legislative changes and the needs of users were not analysed. Although the status of systems development projects was given from year to year, it was not done consistently. There was no analysis or explanation of time delays or changes to the scope and/or cost of systems. Long delays in the development process could be avoided by developing new systems through relatively small projects; that is, by establishing time commitments from development to implementation that do not exceed one or two years. We did not see evidence of this in the Automation Strategy Reviews.

5.73 Without these features, the Automation Strategy Reviews were an assembly of application plans and status reports rather than an overall departmental automation strategy. In addition, critical recommendations in the 1983 Review relating to the scope of the Clientele Profile System and the choice of hardware and software were not followed. In our opinion, the lack of adequate strategic planning and the failure to follow the recommendations of the 1983 Automation Strategy Review contributed to the Department's failure to develop the Clientele

Profile System with due regard to economy and efficiency. The lack of strategic planning also contributed to the failure to develop the Financial Expenditure Control System with due regard to efficiency.

Accountability for Systems Development

5.74 Treasury Board provides guidelines and standards for the development of EDP projects. We used these in our review of the development of the Clientele Profile System and the Financial Expenditure Control System. We concentrated our review on the information that senior managers received to monitor the development of projects and to take corrective action.

5.75 An Excise Systems Review Committee chaired by the Assistant Deputy Minister of the Excise Branch met frequently to review the progress of the Clientele Profile System. For the Financial Expenditure Control System, a steering committee chaired by the Director of Finance was established.

5.76 Extensive information went to these committees and to senior management, but, until recently, there were no detailed schedules with predetermined deliverables, targets and costs. Also, until recently there were few documents recording the decisions of these committees. For example, for the Financial Expenditure Control System, general plans submitted to management were not supported with detailed schedules outlining the tasks to be completed and by whom. The information provided throughout the six-year period changed continually without adequate explanation. It is difficult to understand how senior management could have monitored, taken corrective action and held the project team accountable based on the information provided.

5.77 As another example, except for approvals on specific studies and documents, there were no records of decisions taken by the Excise Systems Review Committee relating to the Clientele Profile System. Without documentation such as the reasons why previously approved studies and documents were not followed, how could the project team be sure that it was implementing the decisions of senior management?

5.78 Customs and Excise is establishing processes to resolve these weaknesses. The Priorities Committee, chaired by the Assistant Deputy Minister, Corporate Management Branch, has been given the responsibility to direct and monitor systems under development. Efforts to prepare a strategic plan that reflects departmental priorities have been initiated. Better information to hold project managers accountable for progress against milestones is now requested and a record of Committee decisions is now kept. We will monitor the effects of these changes.

* * * * *

REMISSION PROGRAMS

5.79 As part of its industrial and trade policy, Canada imposes customs duties on many goods imported into the country. These duties are imposed under the Customs Tariff, an Act of Parliament. There are cases, however, when the government believes it is inappropriate for importers to pay duty on the goods they import. Various tariff relief programs totalling several billion dollars annually have been established to deal with these cases. Our audit focused on one of these tariff relief programs – remissions granted either by Order in Council or the Duties Relief Act.

5.80 The Department of Finance is responsible for tariff and tariff relief policy including setting of objectives. Customs and Excise is responsible for administering remission programs.

5.81 Remissions can be used to reduce or eliminate duties and taxes otherwise payable. For example, the Machinery program permits duty-free entry of qualified machines if they are not available from production in Canada. Remissions can also be used to facilitate international movement of goods and equipment. For example, the Temporary Entry program allows importers to pay a reduced amount of duty on certain goods such as dies and moulds that come into Canada for a short period of time.

5.82 Section 17 of the Financial Administration Act authorizes the Governor in Council, on the recommendation of the Treasury Board, to remit any tax, fee or penalty whenever this is considered to be in the public interest. Order in Council was the authority for the remission programs we reviewed except for the Machinery Program which was authorized under the Customs Tariff. There are hundreds of Orders in Council. The new Customs Act and the Duties Relief Act have brought some changes to the legislative base for tariff relief. These changes do not affect our observations.

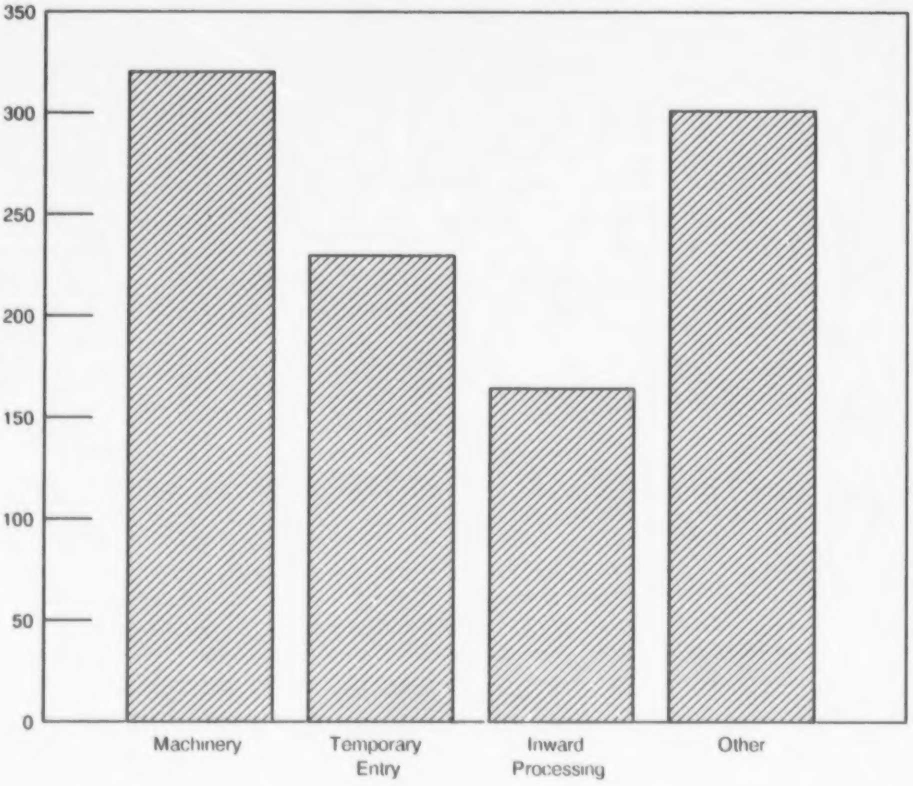
5.83 The new Duties Relief Act brings together five major remission programs. Exhibit 5.4 describes four of the programs included in the Act. It also shows other remissions not included in the Act.

5.84 Our review of the financial management of the programs was done in a similar way to that used to review direct expenditure programs. This included:

- the information provided to Parliament about remission programs;
- whether satisfactory procedures had been established to measure and report the effectiveness of remission programs; and
- the compliance with authorities for remission programs.

Exhibit 5.4

REVENUE CANADA – CUSTOMS AND EXCISE
REMISSIONS REPORTED IN 1985-86
(millions of dollars)



Total $1 billion

The **MACHINERY PROGRAM** permits duty-free entry for machines that come under certain tariff classifications and that are not available from Canadian manufacturers.

The **TEMPORARY ENTRY PROGRAM** provides for a reduction in the amount of duty payable on certain specified goods imported for a temporary period.

The **INWARD PROCESSING PROGRAM** allows Canadian manufacturers to import raw materials duty-free when the resulting finished goods will be exported.

The **OTHER** remissions reported in the Public Accounts include a large number of remissions for specific companies, industries or events.

The **CANADIAN GOODS ABROAD PROGRAM** (not illustrated above) reduces the duty payable on Canadian goods that have to be exported for repairs, additions or further processing if it cannot be done in Canada. It is reported narratively in the Public Accounts.

Information to Parliament about Remissions

Parliament does not have adequate information to assess remission programs.

5.85 In a parliamentary democracy such as Canada, a major role of individual Members of Parliament is to consider and assess the proposals and policies of the government and to hold the government accountable for its actions. To carry out this role, Members of Parliament need clear and reliable information on all types of government programs.

5.86 Parliament currently receives information on government programs from three major sources - the Fiscal Plan, the Estimates and the Public Accounts. The following is a summary of what these documents contain.

5.87 The Fiscal Plan is a forecast based on projected revenues and planned expenditures. It is designed to inform Parliament how the government proposes to allocate public money.

5.88 The Estimates communicate to Parliament in detail the level, nature and objectives of the government's spending plans for the coming fiscal year as well as the actual spending for the previous year. The Estimates respond to the information needs of Members of Parliament who must be able to understand them in order to assess them and hold the government accountable.

5.89 The Public Accounts are an accounting of the financial transactions of the government for each fiscal year.

5.90 The government has several means to carry out its policies including direct expenditures, tax expenditures and remission programs. The documents described above currently provide information to Members of Parliament on direct expenditure programs. We recommended in Chapter 4 of our 1986 Report that tax expenditure information should also be available at the time of the regular budgetary and spending review process. This year we looked at these documents to determine what information they provide on remission programs.

5.91 We found no information on such things as the objectives of remission programs, the results achieved in the past and the expected results in the future. Only the Public Accounts provide any information and, as outlined in the next section, it is not very meaningful.

5.92 For example, under the Machinery Program, over $320 million of duty was remitted in 1985-86. The objectives of the program are set out in a departmental memorandum but not in any of the documents described above. We didn't find any statement of the expected results of the program. The Public Accounts did provide some information on the amounts remitted, as shown in Exhibit 5.5. In our opinion, this is not sufficient to allow Members of Parliament to assess the program and to hold the government accountable for it.

5.93 **The Department of Finance should, in consultation with Revenue Canada - Customs and Excise and other departments, make information on remission programs available to Parliament. This should include their objectives, what they have achieved and what they are expected to achieve.**

> ***Department's response:*** *National Revenue - Customs and Excise will support, to the extent possible, the Department of Finance in its efforts to implement this recommendation.*
>
> ***Department of Finance response:*** *The government believes that duty remission programs are an important element of industrial and trade policy. In this regard, the Department of Finance agrees with the desirability of providing greater information to Parliament on remission programs. Steps are being taken to ensure that the objectives and achievements of remission programs will be reported to Parliament in future years.*

5.94 **Public Accounts.** Section 17(8) of the Financial Administration Act states that: "Remissions granted during any fiscal year under this section shall be reported to the House of Commons in the Public Accounts for that year in such form as the Treasury Board may determine".

5.95 The Receiver General has issued guidelines to departments and agencies on how to report remissions in the Public Accounts. These guidelines state that the following information is to be provided for each type of remission:

- a brief description;
- a listing of names and amounts of remissions of $1,000 or more granted to individuals or companies;
- the amount of all remissions of less than $1,000; and
- the grand total for all remissions.

These requirements result in over 30 pages of Order in Council (PC) numbers and amounts being reported in Volume II of the Public Accounts. An example of this is shown in Exhibit 5.5.

Information on remission programs provided in the Public Accounts is not very meaningful.

5.96 We reviewed the information on remissions provided in Volume II, Part II, Section 3 of the 1985-86 Public Accounts. It shows that over $230 million in duty was remitted under

Exhibit 5.5

REMISSIONS OF TAX, FEE OR PENALTY

Tariff items 41100-1, 42700-1, 42700-2, 42700-3, 42700-4, 42700-5, 42700-9, 42700-10, 42700-11, 42700-12, 42700-13, 42700-14, 42700-15, 42700-16, 42701-1, 42701-2 and 42701-3 provide that in the case of importations into Canada of any goods enumerated in the items, the Governor in Council, on the recommendation of the Minister of Department of National Revenue, may, whenever he considers that it is in the public interest and that the goods are not available from production in Canada, remit the duty specified in these items applicable to the goods. Remissions of duty are less the duty applicable to the first $500 of value for duty in respect of each application. The following remissions were granted on the recommendation of the Minister of Department of National Revenue and the Treasury Board under the provisions of the tariff items and represent customs duty on machinery and parts as described in the various remission Orders and Schedules thereto, the amounts shown representing that portion of the remission applicable to the machinery and parts imported during the period of April 1, 1985 to March 31, 1986 inclusive:

	$
PC 1975 - 2388, October 9, 1975	8,442
PC 1976 - 2651, October 28, 1976	8,779
PC 1977 - 2896, October 13, 1977	1,644
PC 1977 - 3244, November 17, 1977	4,682
PC 1978 - 3624, November 30, 1978	5,731
PC 1979 - 0230, February 1, 1979	1,898
PC 1979 - 2287, August 24, 1979	4,000
PC 1979 - 2826, October 18, 1979	2,393
PC 1979 - 2891, October 18, 1979	1,663
PC 1980 - 1129, May 1, 1980	113,948
PC 1980 - 1518, June 5, 1980	1,812
PC 1980 - 1647, June 19, 1980	25,200
PC 1980 - 1845, July 10, 1980	1,529
PC 1980 - 2621, October 2, 1980	2,391
PC 1980 - 2853, October 23, 1980	24, 242
PC 1980 - 3039, November 6, 1980	79,345
PC 1980 - 3040, November 6, 1980	43,081
PC 1980 - 3199, November 27, 1980	40,884
PC 1980 - 3200, November 27, 1980	166,609
PC 1980 - 3202, November 27, 1980	2,802
PC 1980 - 3467, December 27, 1980	22,051
PC 1981 - 0035, January 8, 1981	15,400
PC 1981 - 0036, January 8, 1981	18,239
PC 1981 - 0037, January 8, 1981	8,450
PC 1981 - 0038, January 8, 1981	6,970
PC 1981 - 0228, January 29, 1981	27,937
PC 1981 - 0235, January 29, 1981	35,608
PC 1981 - 0297, February 5, 1981	27,916
PC 1981 - 0435, February 19, 1981	5,564
PC 1981 - 0592, March 5, 1981	11,533
PC 1981 - 0593, March 5, 1981	38,315
PC 1981 - 0666, March 12, 1981	411,032
PC 1981 - 0667, March 12, 1981	138,417
PC 1981 - 0837, March 12, 1981	110,403
PC 1981 - 0905, March 2, 1981	65,172
PC 1981 - 0978, April 9, 1981	76,766
PC 1981 - 0979, April 9, 1981	54,404
PC 1981 - 1183, May 7, 1981	75,677
PC 1981 - 1184, May 7, 1981	60,569
PC 1981 - 1185, May 7, 1981	490,267
PC 1981 - 1495, June 4, 1981	282,862
PC 1981 - 1496, June 4, 1981	125,758
PC 1981 - 1497, June 4, 1981	142,437
PC 1981 - 1555, June 11, 1981	164,267
PC 1981 - 1649, June 18, 1981	89,690
PC 1981 - 1734, June 25, 1981	101,780
PC 1981 - 1961, July 16, 1981	118,645
PC 1981 - 1962, July 16, 1981	45,419

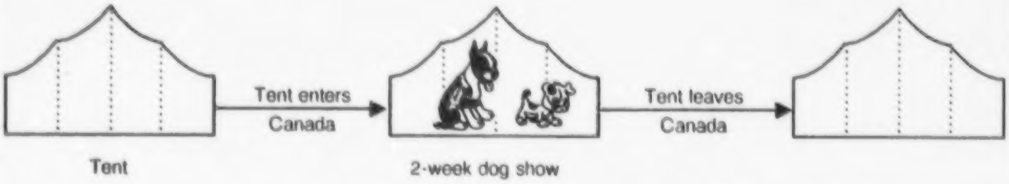
Source: Public Accounts 1985-86

two temporary entry remission programs. These are programs designed primarily to facilitate international trade. We are concerned that, at times, the directives result in reporting as remissions numbers that are not very meaningful. Exhibit 5.6 is an example of what is being reported as a remission under these programs in accordance with the Receiver General's directives. The exhibit shows that an importer who imports a tent that is unavailable from Canadian suppliers for a two-week dog show pays a small fraction of the duty that would be payable if the tent were purchased and kept in Canada. To report the difference as a remission is not, in our opinion, meaningful.

5.97 We also found that the information provided in the Public Accounts does not fully meet the requirements of section 17(8) as interpreted by the Receiver General. In our opinion, the deviations outlined below result from a desire for administrative ease and not from concerns about the meaningfulness of the information reported.

Exhibit 5.6

REVENUE CANADA – CUSTOMS AND EXCISE REPORTING UNDER THE TEMPORARY ENTRY PROGRAM



Full duty on value of tent	$ 16,852
Duty paid under Temporary Entry Program	$ 281
Remission of duty reported in Public Accounts	$ 16,571

We do not consider the remission of duty reported in the Public Accounts under the Temporary Entry program to be meaningful (see paragraph 5.96).

5.98 Some remissions are reported narratively so that the only information provided to the reader is that a given order has been used at least once during the year. For example, the Canadian Goods Abroad Order is used extensively throughout the year in all regions of the country, but the reporting in the Public Accounts, shown below, gives no indication of this. We have been unable to determine how much is being remitted annually under this order.

> **PC 1970 - 1835**, October 21, 1970, provided under prescribed conditions with respect to Canadian articles exported and reimported for the remission of all or part of the customs duties and excise taxes payable in excess of the amounts properly assessed on the cost of repairs made processing or equipment added outside of Canada.
>
> Source: 1985-86 Public Accounts

5.99 In some cases only the total amount of remissions granted during the year is shown. For example, the Goods not as Ordered Remission Order is reported in this way. This does not comply with the Receiver General's requirement to provide a statement of each remission greater than $1,000. As well, we noted that for some of these orders the amounts reported are not complete since some regions are unable to report amounts to headquarters because of the amount of work involved. We are aware of at least $375,000 in remissions granted in one year under the Goods not as Ordered Remission Order that are not included in the total reported in the Public Accounts.

PC 1964 - 235, February 13, 1964, remission of customs duties and excise taxes on goods that are not as ordered:

Remissions	3,786,314

Source: 1985-86 Public Accounts

5.100 In our opinion, the Treasury Board should improve the reporting of remissions in the Public Accounts.

5.101 The Office of the Comptroller General has recently initiated a study on remissions that includes reporting in the Public Accounts.

Evaluating Remission Programs

Remission programs need to be evaluated in the same way as other government programs.

5.102 The Office of the Comptroller General has established a program evaluation framework for evaluating the effectiveness of government programs. Departments and agencies have set up units to conduct evaluations of direct expenditure programs. The government has indicated that it is taking steps to evaluate income tax expenditure programs along similar lines. We believe that remission programs, as part of the tariff relief system, need to be evaluated in the same way as other government programs.

5.103 Remission programs provide significant benefits to the recipients. For example, the objective of the machinery program is:

> ...to increase efficiency throughout Canadian industry by enabling users to acquire advanced equipment not obtainable from Canadian production, yet affording Canadian manufacturers tariff protection on the machinery and equipment they produce as soon as they are in a position to supply.

It would seem reasonable that the departments involved in remission programs and Parliament should know whether the programs are achieving the results expected of them.

5.104 As well, because many remission orders do not have expiry dates, they could continue to be used long after their original objectives have been achieved. The Public

Accounts show that remission orders granted 20 or 30 years ago are still being used. An evaluation could point out whether use of these remissions still makes sense.

5.105 We found that neither the Department of Finance nor Customs and Excise was evaluating remission programs.

5.106 The Department of Finance should take the lead role in ensuring that remission programs are evaluated in accordance with the guidelines issued by the Office of the Comptroller General.

> ***Department's response**: National Revenue - Customs and Excise will support to the extent possible, the Department of Finance in its efforts to implement this recommendation.*
>
> ***Department of Finance response**: The Department recognizes the importance of establishing formal evaluation processes for the programs for which it is responsible. In this regard, action is well underway to implement an evaluation process for tax expenditures. The expertise and methodology being developed by the unit which has been formed for this purpose, will be applicable to the study of duty remission programs. The mandate of this unit is therefore being broadened to include an assessment of duty remission programs and, as time and resources permit, it will undertake such an assessment.*

Cumbersome Process

5.107 One of the reasons for giving government the power to grant remissions is to maintain the capacity to respond swiftly and effectively where it is necessary to rectify anomalies or unintended results in the tax system. The increasing number of requests for remission has resulted in a process that includes consideration by an Interdepartmental Remissions Committee and many levels of approval before an Order in Council is granted. The government must maintain a delicate balance between the importer's desire for quick action and the need to ensure that the requested remission will not adversely affect industry.

5.108 Each Order in Council is like a new piece of legislation and requires careful scrutiny. But this takes time. It can take an importer from 6 to 18 months to have a remission approved if a special Order in Council is required. The impact on the importer could be severe. It could hold up an importation or it could force the importer to pay full duty and taxes and then apply for a refund once the Order in Council is passed. This ties up the importer's capital for long periods. The process has reduced the government's ability to respond swiftly in many cases.

5.109 The government has taken action to streamline the process. The Duties Relief Act authorizes the Governor in Council on the joint recommendation of the President of the Treasury Board and the Minister of Finance or the Minister of National Revenue to remit duties. This has alleviated the need to have the full Treasury Board recommend the remission. As well, the Duties Relief Act authorizes the Minister of National Revenue to remit duties under the Machinery Program in specified circumstances. The Duties Relief Act has also changed the administration of the Machinery Program so that in many cases importers automatically receive the remission without having to go through a formal application process.

5.110 We support these efforts but we believe there are still ways that the government can improve the process. For example, the Duties Relief Act will result in fewer special orders being required under the temporary entry program. Even these orders could be eliminated if the Minister was given the authority to grant temporary entry in specified situations not now included in the Act. Another way might be to remove some of the levels of approval required before an Order in Council is granted.

5.111 **The Department of Finance, in consultation with other departments, should study further ways to implement a more efficient and timely process of providing the tariff relief and facilitating the international movement of goods now given through Orders in Council.**

> **Department's response:** *National Revenue - Customs and Excise will support, to the extent feasible, the Department of Finance in implementing this recommendation.*
>
> **Department of Finance response:** *The Department has long been conscious of the desirability of shortening the time taken to provide tariff relief. The Auditor General's Report notes the Government's recent action to streamline the remission process through changes introduced in the Duties Relief Act. Further streamlining is planned for implementation on January 1, 1988, which should reduce the time taken to produce remissions by another one to two weeks.*

Special Temporary Entry Remissions

5.112 Under the Temporary Entry remission program covered by Order in Council P.C. 1966-643, importers can bring certain classes of goods into the country for a temporary period of up to one year and pay duty at the rate of 1/60th of the regular duty for each month the goods are in the country. The Temporary Entry Remission Order has 29 classes covering various temporary importation situations.

5.113 Importers have found that some of the goods they want to import temporarily are not listed in the existing 29 classes of the Order. In other cases, the goods are needed for more than 12 months but are still considered to be a temporary entry. Exceptions to the classes in the Order and extensions beyond 12 months must be handled through a special temporary entry remission order.

Special temporary entry remissions were granted in the absence of legal authority.

Exhibit 5.7

EXAMPLE OF SCHEDULE TO TEMPORARY ENTRY REMISSION ORDER BEFORE 1982

IMPORTER	GOODS	CIRCUMSTANCES
	1, 30" Kaliper Pig and accessories	This equipment not available from Canadian sources, is required to test and monitor weak spots and construction errors on a buried pipeline. Authority is requested to allow importation of this equipment on a 1/60 basis for a period not to exceed four months from the initial date of importation.

EXAMPLE OF SCHEDULE TO TEMPORARY ENTRY REMISSION ORDER AFTER 1986

	Column I	Column II	Column III	Column IV	Column V
Item	Importer	Goods	Purpose of Import	Temporary Entry Program Number	Temporary Entry Period Computed from Date of Importation of Goods
1.		Fixtures	For use in friction welding	00101	25 months
2.		Die	For use in the production of automotive parts	00102	24 months
3.		Die	For use in the production of automotive parts	00103	24 months

5.114 **Authority.** Customs and Excise is required to collect duties in accordance with the Customs Tariff unless there is authority to remit the duties. Departmental officials normally allow special temporary entry remissions before receiving Order in Council authority so as to facilitate the international movement of goods. There is no legal basis to do this. Requests for special temporary entry are made at the regional level. If the request is considered valid, the regional office notifies the importer, in writing, that entry on a 1/60th basis is allowed and that a request will be referred to the Deputy Minister for consideration of a special Order in Council. The notification letter further states that it is understood that the importer will accept the responsibility for payment of the balance of the applicable duty and taxes on the full value of the goods in the event of an unfavourable decision.

5.115 **Revenue Canada - Customs and Excise should seek legal means of remitting duties on temporary entry remissions at the time of entry.**

Department's response: *The Department of Finance is responsible for tariff and tariff relief policy. National Revenue - Customs and Excise will make representations to the Department of Finance for legislative changes permitting the remittance of duties on temporary entry remissions at the time of entry. The changes sought would allow temporary remissions to be processed in a timely manner, thus avoiding economic hardship on importers while providing the Department the legal basis for administering the process.*

5.116 **Lack of urgency.** Allowing entries without a legal basis became more significant when no special temporary entry remission orders were passed for a four year period. Until 1982, these remission orders were handled in batches and processed at regular intervals. In 1982, the Privy Council Office requested a change to the format of the remission order. It took four years to agree on the new format. As illustrated in Exhibit 5.7, the new format essentially adds two columns of information to the remission order. Consequently, no special temporary entry remission orders were passed between 1982 and 1986. This resulted in a backlog of over 1,400 applications, representing several million dollars of duty remitted to importers, which is in the process of being cleared.

DEPARTMENT OF AGRICULTURE

DEPARTMENT OF AGRICULTURE

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6

DEPARTMENT OF AGRICULTURE

6.1 The financial management and control study in the Department of Agriculture commenced in September 1986 and was completed in March 1987. The study findings apply to the Department of Agriculture and to certain activities and transactions of the Canadian Forestry Service.

Scope and Approach

6.2 The study in the Department was based on selected elements of financial management used to assess planning, budgeting, controlling and reporting in all the departments covered by the Financial Management and Control Study. Areas of particular attention were:

- planning and budgeting;
- management of capital assets;
- inventory control;
- grant and contribution payments;
- cost recovery;
- role of the financial function;
- financial reporting; and
- information provided to Parliament in the Estimates.

6.3 Our study took place primarily at the Ottawa headquarters of the Department of Agriculture and the Canadian Forestry Service. We carried out regional examinations with respect to the Prairie Farm Rehabilitation Administration in Regina, the Western Grain Stabilization Program Administration in Winnipeg, the Petawawa National Forestry Institute and the Great Lakes Forestry Centre in Sault Ste Marie.

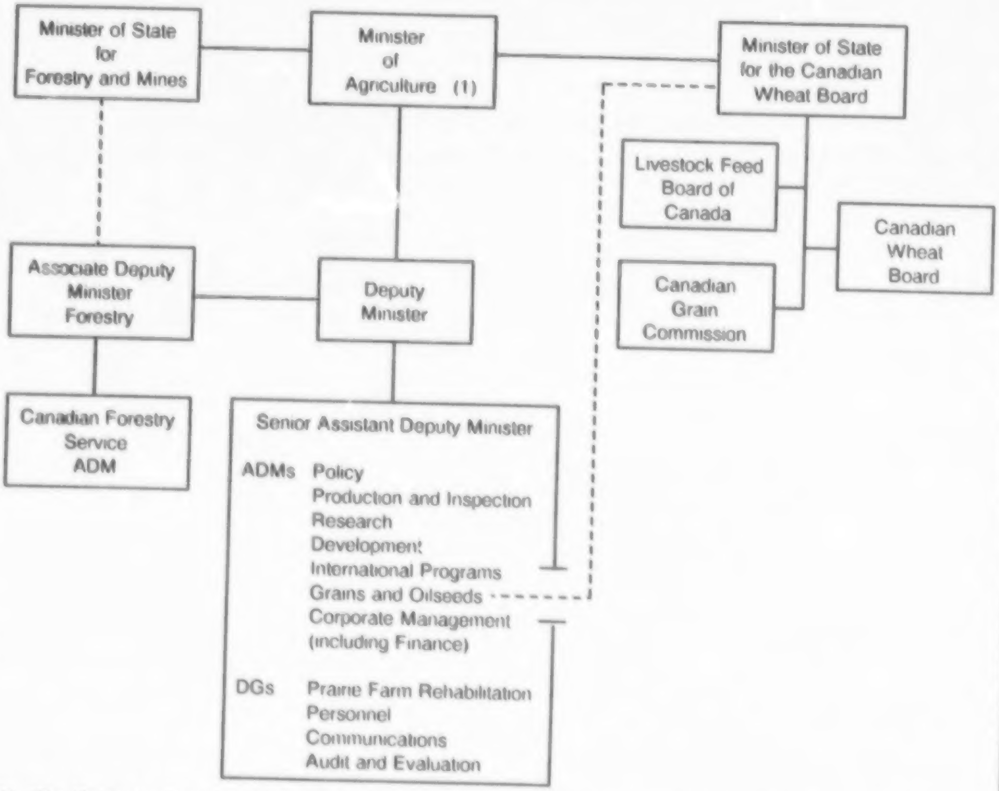
6.4 We examined key documents such as Treasury Board submissions, operational plan frameworks, multi-year operational plans and annual budgets. We also examined documentation for program implementation, minutes of senior management meetings and various staff papers. Cabinet records of decision were obtained as considered necessary. Finally, we also reviewed internal audit plans and reports and conducted interviews with program managers, administrative staff and financial officers.

Organization and Budget

6.5 The organization and budget of Agriculture Canada, including the Department of Agriculture, are shown in Exhibits 6.1 and 6.2.

Exhibit 6.1

AGRICULTURE CANADA


Minister of State for Forestry and Mines
Minister of Agriculture (1)
Minister of State for the Canadian Wheat Board
Livestock Feed Board of Canada
Canadian Wheat Board
Canadian Grain Commission
Associate Deputy Minister Forestry
Deputy Minister
Canadian Forestry Service ADM
Senior Assistant Deputy Minister
ADMs Policy
Production and Inspection
Research
Development
International Programs
Grains and Oilseeds
Corporate Management (including Finance)
DGs Prairie Farm Rehabilitation
Personnel
Communications
Audit and Evaluation

(1) The Minister is also responsible for the following entities: Pest Management Advisory Board, Farm Credit Corporation, Canadian Dairy Commission, Agricultural Products Board, Agricultural Stabilization Board and the National Farm Products Marketing Council.

Exhibit 6.2

AGRICULTURE CANADA EXPENDITURES AND PERSON-YEARS

	In original dollars ($ Millions)			In 1981 constant dollars ($ Millions)		
EXPENDITURES	1987	1981	1975	1987	1981	1975
Personnel and Operating	795.8	383.7	195.6	587.3	383.7	334.4
Capital	139.7	20.3	11.5	103.1	20.3	19.7
Grants and Contributions	1,456.6	516.9	457.6	1,075.0	516.9	782.2
Authorized Person-years	13,036	12,430	11,997			

6.6 Financial management and control in the Canadian Forestry Service are the responsibility of the two Ministers, the Deputy Minister of the Department of Agriculture, and the Associate Deputy Minister (Forestry). Although Forestry is not a department, it has operated more or less independently since it became part of the Department of Agriculture in 1984. But it is funded by Agriculture votes. The working relationship between Forestry and the Department of Agriculture is developing gradually. We did not examine this in detail, but we noted that the relationship between the senior financial officers of Forestry and Agriculture is not formalized and that independent financial systems are maintained.

6.7 The Canadian Wheat Board, which reports to a Minister of State, is a corporate body with its own Act. It is not subject to the accountability and financial management provisions of Part XII of the Financial Administration Act. The Board was not included in our study.

6.8 A new planning element for grains and oilseeds was created in the Department of Agriculture during 1986. The Minister of Agriculture, the Deputy Minister and the Minister of State for the Wheat Board share responsibility and control for activities relating to grains and oilseeds.

6.9 The Agriculture Canada budget has increased significantly since 1975, primarily because of the magnitude of transfer payments to Canadian farmers. In 1987, about 77 per cent of the aggregate net income of all farmers is expected to be derived from federal and provincial assistance payments according to analysis prepared by the Department. In 1986, about 40 per cent of farmer grain receipts came from governments. In total, federal statutory payments to grains and oilseed producers was a record $1.4 billion for fiscal year 1986-87, with benefits from other federal programs totalling a further $1.2 billion.

6.10 Also, several other federal entities provide programs for the agri-food sector. The Farm Credit Corporation reports to the Minister of Agriculture and is responsible for some $5 billion in loans to farmers. The Canadian Dairy Commission also reports to the Minister of Agriculture and delivers the dairy program, which includes payments of about $277 million a year in subsidies to industrial milk producers as well as administering export sales of dairy products in excess of $200 million a year. In addition, departments such as Transport Canada and External Affairs have programs for the benefit of farmers and agriculture-related industries.

Operating Environment

6.11 The Department of Agriculture is undergoing significant organizational and management changes. Branch structures and responsibilities were realigned in 1986. New senior managers are redefining branch priorities and mission statements. Accountability and reporting relationships are also being redefined. Systems and practices continue to be modified. New management committees have been formed and are refining their objectives and functions as they proceed.

6.12 Major issues, both international and domestic, have emerged to challenge the government and the Department. At the same time, the Department has absorbed cumulative budget reductions of $163 million and 613 person-years since 1982. Also, the 1985 Nielsen Task Force on Agriculture made many recommendations. The Department is responding to these different pressures in several ways:

- developing preliminary commodity-based strategies intended to link the various activities of the Department;
- completing a review in 1986 to identify opportunities for savings in departmental administration;
- completing budget reviews by two operating branches; and
- taking initiatives to streamline planning.

6.13 The national strategy for agriculture, approved by federal and provincial Ministers of Agriculture and published in November 1986, has helped to establish a focus for departmental strategies. So has the Department's participation in federal and provincial working groups to address issues such as farm incomes, soil degradation and technology transfer.

6.14 The Department met a budget reduction target of $75 million for 1986-87. Over the next three years an estimated budget reduction of some $100 million is to be made. In this operating environment, financial management and control are increasingly important. More reliable costing of activities and establishing priorities and future funding requirements are also necessary. Accurate forecasting of current year expenditures is also important, as are techniques for cost-benefit analysis of alternatives and the costing of services for the purpose of cost recovery.

6.15 It is likely that budget reductions have encouraged better financial management and control. However, some adjustments to meet budget reductions may merely be deferring problems. For example, facilities maintenance and equipment replacement requirements now exceed amounts budgeted, and there are development agreements yet to be fully funded. The Department is aware of these problems and is discussing them with Treasury Board.

Main Messages

6.16 Since the 1975 Financial Management and Control Study the Department has improved systems and practices. But there are still problems in the management and control of transfer payments, capital assets, inventories and cost recovery and in the systems that support resource allocation activities. The Department is aware of these weaknesses and is addressing each of them.

6.17 The financial impact of these shortcomings is potentially high, particularly in transfer payment programs such as Western Grain Stabilization, Crop Insurance, Agricultural Stabilization and ad hoc programs such as Crop Drought Assistance and the Special Canadian

Grains program. Even though the financial stakes are high, financial officers play a limited role in transfer payments. Our 1986 comprehensive audit reported a lack of information and analysis for managing the Western Grain Stabilization Fund and Crop Insurance plans. Our tests of the large annual transfer payments made by the Department showed overpayments and errors of $4.2 million over several years. And there was questionable compliance with authority. Similar more recent instances are discussed later in this chapter and in Chapter 3, Audit Notes.

6.18 The partnership between the financial function and program management could be stronger. Program and financial officers do not consult meaningfully about the financial implications of program goals and the use of resources. Independent challenge of spending and resource allocation by the senior financial officer has not been emphasized. Monitoring by the senior financial officer of management improvement projects was discontinued in March 1986, and departmental training in financial skills is not intensive.

6.19 The management of financial information resources and the financial allotment control system have worked reasonably well. The problems in these areas include limited time to replace the present financial information system before the current agreement terminates, duplication of financial information systems, backlog in systems development and lack of information on the allocation of management information resources.

6.20 We found the accountability framework wanting. But the Department is in the process of building it. Gaps in the resource planning and allocation process are also being filled. Once this is complete, Parliament should be better informed on the performance as well as the scope and cost of agriculture programs.

6.21 There are some areas in the Department where good financial management is visible:

- Annual interest costs were lowered by more than $1 million in respect of loans under the Advance Payments for Crops Act.
- Public Works Canada was notified of some lands surplus to the requirements of the Department. Further land divestment will require consideration of program priorities and cost-benefit analysis.
- Adequate control is exercised over $13 million in revenues of the Race Track Supervision Revolving Fund.
- A timetable for internal audits across the Department has been established with coverage of all Branches.
- Cost-shared farm income protection programs for certain commodities were introduced in 1986 and 1987, spreading the financial and other risks among the producers, the provinces and the federal government.

6.22 Our 1986 comprehensive audit of the Department reported several weaknesses in financial control, the more important of which are summarized below:

- lack of control over the transfer of funds to the Canadian Dairy Commission;
- calculation and other errors by the Agricultural Stabilization Board that resulted in overpayments to producers between 1981-82 and 1984-85 totalling $2.2 million;
- lack of analysis of the alternative ways to calculate the level of support payments under the Agricultural Stabilization Act;
- the granting of financial assistance to a processor that conveyed an interest benefit of approximately $200,000;
- procedures for setting crop insurance premiums that did not set a reserve target related to the variability of crop yields to ensure self-sustaining plans; and
- the absence of a system to report and monitor actual research project costs.

The Department has advised the Public Accounts Committee that it is addressing the recommendations made in our 1986 comprehensive audit report.

6.23 More recent items also indicate a lack of financial management and control from time to time:

- Payments totalling $12.2 million for crop drought assistance were given post-approval by Treasury Board. These payments diminished the cost-effectiveness of the program because 6,080 producers received compensation they were not eligible for under the terms specified for drought assistance. Moreover, producers were also compensated, in part, for the same losses through government-sponsored crop insurance plans.
- The sale of product inventories and disbursement of funds by the Agricultural Products Board were made in a manner inconsistent with the Financial Administration Act and contrary to the Board's enabling legislation (see audit note in Chapter 3).
- Accelerated payments of some $1 million in contributions were made to an educational institution (now being recovered).
- There was an inconsistency in calculations for the 1985-86 grain corn support program under the Agricultural Stabilization Act. This resulted in approximately $880,000 more being paid than necessary.
- The Canadian Forestry Service overcommitted $6 million against funds sub-allotted by Treasury Board and, more important, it exceeded parliamentary appropriation by some $1.3 million. A further excess of $1.6 million would have been reported had payment claiming documents been promptly received and processed (see audit note in Chapter 3).

Follow-up to 1975

6.24 Most of the matters reported by the 1975 Financial Management and Control Study have been addressed. Internal audit, in particular, has become stronger. We note, however, that certain observations have been only partially rectified:

- The new financial manual is silent on the allocation of responsibility for resource management between finance and program management, on overall policies for financial management, and on procedures for resource allocation and control.
- The senior financial officer's position is not identified in the financial manual and the officer's responsibility for asset, payroll and other expenditure control is not clearly defined.
- In the management of accounts receivable, amounts due from producers still remain outstanding for extended periods. As of 30 September 1986, for example, some $28 million or 87 per cent of total receivables were over 90 days past due. Of this amount, some $16 million was considered uncollectible.
- Capabilities for determining costs and rates in respect of cost recovery need to be further developed.
- There are gaps in the accounting control over inventories. The completeness of equipment records is not assured.

6.25 Action on matters such as these would demonstrate support for the financial function and enhance its role in the Department. Costing capabilities are particularly important in view of recent cost recovery efforts and the implementation of commodity-based strategies.

6.26 The Department of Agriculture should address further the recommendations outstanding from the 1975 Financial Management and Control Study relating to the functional authority of financial officers, the financial manual, the review and monitoring of fees, the collection of receivables, inventory control and the costing of activities.

> **Department's response:** *The Department will amend the Financial Management Manual to clarify the allocation of financial responsibility and the role of the senior financial officer by January 31, 1988.*
>
> *The Department will, subject to appropriate legislative and legal considerations, substantially reduce the level of accounts receivable over 90 days past due, by March 31, 1988.*
>
> *The Department will address the issues of inventory control and the review and monitoring of fees and the costing of activities in the responses to Recommendations 6.64 and 6.73 respectively.*

Accountability Framework

6.27 The Department of Agriculture has worked on an Operational Plan Framework since 1983 to serve as the basis for resource allocation and to facilitate the reporting of results for accountability purposes.

6.28 The first framework was approved by Treasury Board in September 1985, on the condition that work be completed to clarify the intended results of programs and the linkages between objectives, resources and results. This was not completed and our 1986 comprehensive audit reported shortcomings in this regard. This version required substantial revision after about one year.

6.29 The framework was scheduled for revision by May 1987. Treasury Board approved initial amendments in January 1987. New programs and planning elements have been defined and others realigned. Concurrently, the Department is considering what performance measurements to use and the system required to produce them. Similarly, a framework for Forestry is being implemented.

6.30 The 1985 Operational Plan Framework was an extensive document, but it lacked precision. Revision efforts are intended to ensure that a framework is established that can be more easily changed as circumstances warrant and becomes a meaningful and useful document for financial management within the Department.

6.31 Until an accountability framework is defined and implemented through financial and performance measurement systems, the Department cannot effectively show the relationship between resources and results planned and those actually spent or achieved. This limits the Department's ability to assess alternatives, measure the achievement of objectives, implement new priorities, and re-allocate limited resources in line with its strategic aims and priorities.

6.32 The Corporate Management Branch maintains the Department's financial reporting system. Each branch is expected to develop its own performance measures. Responsibility for matching spending with results is not specified. Therefore, although expenditures are being captured, results are not always systematically measured. Conversely, where results are measured, they may not always be matched to resource consumption.

6.33 The Department is also implementing a new comprehensive personnel system for the annual appraisal of management performance. However, standards for assessing performance against budget are not specified. As a result, appraisals may be inconsistent or incomplete, and accountability for day-to-day resource management may not be given sufficient emphasis.

6.34 **The Department of Agriculture, including the Canadian Forestry Service, should complete Operational Plan Frameworks. Also, the matching of resource consumption with measurements of program results should be planned and monitored.**

Finally, performance appraisals of management should include criteria for assessing the management of resources in relation to program results achieved.

> **Department's response**: *The Department will complete the Operational Planning Frameworks by June 1, 1988. The matching of resource consumption with measurements of program results will be strengthened in the annual Operational Plan exercise starting with the fiscal year 1988-89. Monitoring of resource consumption against program results will be the responsibility of individual managers but a departmental review will be conducted by the departmental Resource and Program Review Committee on a semi-annual basis starting with the fiscal year 1988-89.*
>
> *The Department agrees that the new comprehensive personnel system for annual appraisal of management performance does not include standards for assessing performance against budget and results achieved. However, the Department has given the responsibility to set standards for performance against all managerial responsibilities to individual managers.*
>
> *To ensure that managers are appraised on performance against budget and results the Department will:*
>
> - *Undertake a survey of performance appraisals by February 1988.*
> - *Remind managers, in writing, of their responsibilities regarding goal setting to reflect standards for financial resources and results, by January 1988.*

Program Planning and Implementation

6.35 The Department is revising its planning and resource allocation processes and outputs. A specific strategic direction document to guide branch planning had not been issued since 1984 although, during this period, the Department was responding to the requirements of the Nielsen Task Force. A draft departmental strategic plan was ready in late March 1987 and was issued in final form in April 1987. Branch heads are also preparing annual plans to link corporate strategic direction, resource allocation and work planning. The Canadian Forestry Service is preparing its strategic plans and is linking these with budgets and work plans.

6.36 Work planning systems are reasonably well developed, but could be improved by better costing capabilities. Work plans produce considerable information, but they are not well integrated with financial information systems. This has potential for inefficiencies and the production of inconsistent information for financial planning and control. The topic is addressed further under Information Management.

Grants and Contributions

6.37 The Department's role in planning and implementing transfer payment programs raises fundamental questions. The new Policy Branch aims to anticipate conditions in the agricultural sector more effectively and to prepare strategies in advance. This will require, among other things, measuring past and future farm income trends as a basis for developing policy options. Doing this is difficult, but it is both necessary and important, because government transfer payments have increased dramatically. The Department is showing improvement in meeting these requirements, but results have yet to be demonstrated.

6.38 In the Special Canadian Grains Program, the federal government will have paid up to $1 billion to Canadian producers of grains and oilseeds by July 1987. Of this, about $293 million had been paid by 31 March 1987. This non-statutory program represents the largest single payout ever to Canadian farmers. It was announced on 9 December 1986 and reflected the Government's commitment of 3 October 1986 stated in the House of Commons:

> . . . we will be working closely over the next month with Premier Devine and other provincial governments to devise an effective financial assistance program to enhance the cash flow of Canadian grain farmers. Initial estimates of the assistance required are that it will amount to approximately $1 billion.

6.39 We examined the Department's role and function in this program based on documentation provided by the Department. An internal document, dated 1 October 1986, showed that although the Department was working on a farm income assistance strategy, it was not sufficiently advanced and costed. Commodity-based development strategies were also not at an advanced stage.

6.40 There is no evidence that the Department was the source of the recommendation that a $1 billion cash flow assistance program be introduced. In fact, senior departmental management became aware of the commitment only a few days before the 3 October 1986 announcement. Once the Government announced its commitment, however, the Department proposed options for fulfilling it and mobilized quickly to deliver a program. The analysis, timing, payment method, cost and financing for the program were all defined after the Government had made its commitment of $1 billion. The Department's finance group arranged to issue cheques and was not involved in the supporting analysis for the program, although we have been advised that it was involved in discussions.

6.41 The options presented for consideration by the Ministers included the payment of grants, bond issuance, interest-free loans, enhancement of existing programs, guaranteed purchase of crops, deficiency payments and various combinations of these options. One-year cost estimates ranged from $300 million to $1 billion. Cabinet approved $1 billion of deficiency payments under the Special Canadian Grains Program on 2 December 1986. The decision was not supported by the usual submission prepared by the Department, although an informal document outlining options was available to Ministers. A deficiency payment is normally determined by comparing current market values and production costs to historical averages. The $1 billion was not calculated in this way. We could not find out how this number was calculated.

6.42 Legislative authority for the program is cited as sub-section 5(2) of the Department of Agriculture Act. This section provides that "The Governor in Council may at any time assign any other duty or power to the Minister of Agriculture". This wording has remained unchanged since 1868 and has been used as the legislative basis for other ad hoc or temporary programs.

6.43 The use of sub section 5(2) as the legislative basis to create a new $1 billion program is questionable. The effect is to transfer the law-making power and control of Parliament to the government beyond simply the assigning of powers. In our view, using sub section 5(2) in this manner cannot be appropriately supported by analysis of the wording in this section of the Department of Agriculture Act.

6.44 The $1 billion was approved by Parliament through two Supplementary Estimates. Supplementary funding of $300 million for the 1986-87 fiscal year was approved on 18 December 1986, and the remaining $700 million for fiscal 1987-88 was approved on 24 March 1987. Normally, Supplementary Estimates are used to secure additional funds during a fiscal year already in progress, not for future fiscal years. We were advised that this was done to ensure that the $700 million would be paid out in full and would not be constrained by interim supply based on the Main Estimates.

6.45 The purpose of the program is to assist producers who have experienced dramatic income drops as the result of international policies. Canadian grain producers as a whole are considered to be adversely affected by the policies of other countries that have produced downward trends in grain prices (see Exhibit 6.3). Therefore, individual producers are not required to meet income tests or financial conditions to be eligible for payment under the program. After consultation with farm leaders, payments were to be made to individual grain farmers based on a single national program so as to treat all producers uniformly. This appears to account for the inclusion of livestock feed grains under the program. Such grains, however, are not directly affected by export prices and the risks to such producers are more in the livestock feed market. In addition, acreage cut for silage or ploughed under following damage or failure in 1986 became eligible under revised program terms and conditions in June 1987 after initial payouts of some $293 million.

6.46 Rates of payment for eligible crops have been calculated based on the estimated effect of several factors including the U.S. loan rates and subsidies of other countries. Therefore, the $1 billion is being distributed based on the relative effect of international policies on grain prices.

6.47 Analysis supporting the program was incomplete in two respects:

- Although the program has been described as a supplement to producer incomes, analysis did not isolate the current effect on farm income of domestic grain prices and sales, revenues from products other than grains, or the amount of off-farm income of grains and oilseeds producers. This was not viewed as necessary since the purpose of the program was to compensate for a decline in incomes caused by international policies rather than to sustain any given level of incomes.

- Analysis of spending and costs under other government assistance programs was reasonably complete but did not separately identify the 1987 Western Grain Stabilization Act payouts in the order of $1.4 billion. The stacking or layering effect of the $1 billion payout on top of this and other support programs was not measured and provided as financial information for decision making.

Exhibit 6.3

CANADIAN WHEAT BOARD BASE PRICES PAID TO WESTERN FARMERS FOR MAJOR GRAIN DELIVERIES

$ per tonne

Pool Account Years	No. 1 Canada Western Red Spring Wheat		No. 1 Canada Western Amber Durum Wheat		No. 1 Canada Western Barley	
	Initial Payment Price	Total Realized Price	Initial Payment Price	Total Realized Price	Initial Payment Price	Total Realized Price
1980-1981	156.16	222.12	183.72	239.58	124.01	146.55
1981-1982	174.50	199.62	174.50	200.34	124.00	131.07
1982-1983	174.50	192.34	174.50	187.45	110.00	110.00
1983-1984	170.00	193.98	165.00	204.04	95.00	138.02
1984-1985	170.00	186.37	180.00	204.85	110.00	131.30
1985-1986	160.00	160.00	160.00	181.30	110.00	110.00
1986-1987	130.00		130.00		80.00	
1987-1988	110.00		110.00		60.00	

Source: 1985-86 Annual Report of the Canadian Wheat Board

Note: 1986-87 and 1987-88 market years are in progress. Total realized prices have not been determined as yet.

6.48 In June 1986, international grain prices dropped significantly. Coincidentally, the Department and the Department of Finance began to diagnose problems in farm finances. The diagnosis was broad in scope; there was no focus on grains or a $1 billion program. Had the Department developed options and costed strategic plans much earlier, decision makers could have been provided with more information on alternatives, costs and benefits as well as more time to evaluate policy options.

6.49 The need for $1 billion of assistance is, to some extent, the result of unsuccessful past efforts to reach pricing and other economic terms in international grain agreements. Had this been possible, the battle over international markets and subsidies might have been mitigated. The absence of mutually agreed terms on price and supply have also contributed to accelerated payments out of the Western Grain Stabilization Fund, leading to a deficit of approximately $844 million at 30 June 1987 and $201 million in 1985-86 pool account deficits in the Canadian Wheat Board. These are heavy costs to Canadian taxpayers and a considerable burden to the treasury. The Department is now working on longer-term solutions for Canadian grains and oilseeds and the reduction of agriculture subsidies.

6.50 The Special Canadian Grains Program has been classified and reported to Parliament as a contribution, both in the Estimates and in Volume II of the Public Accounts of Canada. However, it has been accounted for as though it was a grant in the government's summary financial statements in Public Accounts Volume I (Section 2). Under the government's accounting policies, grants are normally charged to expenditure in the year in which they are paid (cash basis); contributions, however, are normally charged to expenditure in the year during which related applications and certifications are received, even if payment is made later (accrual basis).

6.51 Funding of the $1 billion Special Canadian Grains Program was split between two fiscal years – $300 million through Supplementary Estimates for the year ended 31 March 1987, and $700 million through Supplementary Estimates for fiscal 1988. Because the program was classified as a contribution, and most of the related applications and certifications were received from producers by 31 March 1987, one would expect the full $1 billion program cost to be included in the 1987 deficit. However, the 1987 deficit only includes payments made during the year of some $300 million; about $700 million will be included in 1988 as the remaining payments are made. We believe that this accounting treatment violates the substance of the Government's accounting policies for contributions.

6.52 The classification of the program has implications that extend beyond accounting and financial reporting. Normally, a contribution is a payment conditional on contractual terms and conditions being met. It is often a contribution to a cost-shared endeavour, and payments are usually scheduled according to specific dates and amounts. This is not the case for the Special Canadian Grains Program. It is not cost-shared, and an agreement does not exist requiring recipients to spend the money in any particular way or to undertake courses of action as a condition for receiving payments from the public purse. The payments are made with no strings attached and no contractual arrangement exists. For example, there is no requirement for a producer to harvest crops, to change seeding patterns, to modify other farming practices as part of a longer-term strategy for solving problems, or to repay amounts previously owed to the Crown, if any. Producers may spend the money in any way they wish. Producer eligibility for payments in 1987 is based on having already seeded acreage in 1986 in any of 10 eligible crops intended for harvesting that year. This means that payments under the program are more in the nature of grants.

6.53 The Government maintains that:

> "the program was administered on a contribution basis to ensure adequate financial management and administration of the program. Because the contribution program was announced on an ex poste basis, it has certain of the characteristics of a grant program. Furthermore, all spending requires parliamentary approval and approval for the program was granted in two fiscal years - $300 million in 1986-87 and $700 million in 1987-88. Accordingly, the $700 million payment in 1987-88 represents a commitment only, and as the Government does not give accounting recognition to commitments, no provision has been made for this at March 31, 1987."

6.54 As mentioned earlier, it appears that the program has more of the characteristics of a grant than a contribution. However, many of the traditional controls over grants are lacking. For example, grants are identified by individual recipient or class of recipients in the Main Estimates when Parliament approves their funding. Grants may not be paid by the government to anyone not specifically identified. On the other hand, contributions are listed in the Estimates for information purposes only. The government and the Department are not

Exhibit 6.4

ANALYSIS OF CONTRIBUTIONS PROVIDED IN MAIN ESTIMATES

	Fiscal Year 1986-87 ($ millions)	Fiscal Year 1985-86 ($ millions)
Total funding for items listed in Main Estimates	671	621
Expenditures	1,081	760
Variance	61%	22%
Amounts originally listed in Main Estimates that were paid	658	621
Additional amounts paid for items listed in Main Estimates	44	54
Programs that were listed in Main Estimates but not paid	13	1
Programs paid but not originally listed in Main Estimates	392	86

constrained from spending contributions for purposes or programs not mentioned in the Estimates, and can establish or modify the terms of a program. Analysis of contribution spending reveals a considerable difference between the amounts initially identified in the Main Estimates and those eventually spent (see Exhibit 6.4). Reallocation of contribution funds is normally approved by Treasury Board and funded by amounts already voted by Parliament. Supplementary Estimates are submitted to Parliament when additional Funding is required.

6.55 In conclusion, the usual process for planning, implementing and financing a program was not followed for the largest single agriculture payment program ever introduced by a Canadian government. Implementation policies and practices for a contribution program were not fully and clearly applied. The use of subsection 5(2) of the Department of Agriculture Act is questionable and, combined with funding through the contribution method, provides a large degree of flexibility and authority without a corresponding degree of accountability to Parliament in terms of reporting costs and results achieved.

Capital Assets Management

6.56 The Department's resources in land and facilities have an estimated replacement value in excess of $3 billion. There are over 3,000 buildings across Canada located on approximately 2 million acres of land. About 65 per cent of the buildings are over 25 years old. Capital budgets have been curtailed but spending on facilities over the past three years is at an average of about $50 million a year. Maintenance requirements are estimated to be accumulating, but funds for maintenance are not budgeted or controlled at the corporate level. Moreover, a 1983 departmental survey of 63 laboratories found, among other things, that 54 per cent of space was being used for functions different from those for which it had been designed, and most of them were deficient in fire protection.

6.57 The Department has recently undertaken several initiatives to integrate the management of capital assets with program needs. Until this transition is complete, the Department's ability to manage capital assets is limited. Our concern is compounded because of the following deficiencies recognized by the Department:

- at the corporate level, there are limited means of measuring and monitoring maintenance activities, and a lack of current and accurate information on asset existence, use and availability;
- independent functioning of program planning on the one hand and capital asset planning and control on the other;
- inadequate needs analysis in support of decisions to construct new facilities, and incomplete life-cycle costing for capital projects;
- lack of evaluations following completion of projects;
- purchase of equipment in advance of need;
- delay in providing a capital strategy to Treasury Board; and
- the exceeding of project approval by $1.9 million in the construction of a new $35 million research facility at St. Hyacinthe.

There have also been difficulties in controlling capital budget positions at or near year end, with the result that 1985-86 appropriations were exceeded by $663,000.

6.58 The Department is concerned about these situations and is addressing them. For example, the Department is:

- reviewing the asset base and reworking capital plans and priorities;
- updating and validating property inventories;
- achieving efficiencies by consolidating facilities;
- establishing a new priority rating system to allocate capital funds where they are most needed; and
- developing maintenance work plans.

6.59 The Department of Agriculture is working to improve its planning and control for capital assets. We will monitor these efforts as part of our continuing audit work.

Inventories

6.60 Systems and practices for inventory management and control are generally weak.

6.61 The Department maintains a central equipment management information system (EMIS). Although it captures equipment additions and deletions, and provides information on cost and replacement requirements, it is used primarily for inventory record keeping. It is inadequate as a financial management and control tool because it lacks current information on condition, utilization and availability of equipment.

6.62 Other financial management deficiencies relating to inventory management and control that we identified included the following:

- The completeness of EMIS records is not assured because responsibility centres do not ensure that all inventory items are recorded. Also, inventory additions are not reconciled with the Department's financial system to ensure that all additions are recorded.
- EMIS reports are not used to identify equipment replacements. It is not clear how equipment purchase decisions are related to branch or corporate priorities or why EMIS data are not used for determining actual purchases.
- Neither the Corporate Management Branch nor the Research Branch is aware of the reasons for a large difference between replacement requirements and available funding. The initial five-year equipment replacement strategy (intended to cover 1984 to 1988) appears to have lost its direction. According to EMIS, the Research Branch has equipment replacement requirements of $70 million while the current budget for all branch equipment purchases is only $17 million. No attempt has been made as yet to reconcile these figures and to develop a strategy to manage the gap.

6.63 Internal audits have reported inventory control and staff training problems related to equipment, supplies and livestock, including:

- lack of control over the receiving function and the recording of additions;
- inadequate control over issuances, deletions and disposals;
- lack of physical counts to verify records;
- inadequate segregation of duties and safeguards against loss; and
- inadequate safeguards for hazardous materials.

6.64 **The Department of Agriculture should assess management practices related to inventories and provide enhanced training to management and staff in managing inventories. Appropriate financial and management controls should be introduced as soon as possible to the inventory system.**

> ***Department's response**: The Department agrees and specific steps are being taken to strengthen financial management and controls of the equipment inventory and to improve assets management practices as follows:*
>
> 1. *An assessment of current inventory management practices will be completed by October 31, 1987.*
> 2. *Based on this assessment, necessary policy, procedures and training will be developed by December 31, 1987.*

3. *Strengthened financial controls over equipment acquisition and disposal will be developed and implemented by March 31, 1988.*

4. *A feasibility study on systems requirements for equipment condition, utilization and availability will be carried out by March 31, 1988.*

Cost Recovery

6.65 Our work in revenue and cost recovery focused on the Food Production and Inspection Branch, which represents a significant source of departmental revenue through cost recovery. We also examined the progress of the Research Branch toward cost recovery.

6.66 We reported in 1975 that the Department had no system to identify instances where it might be appropriate to introduce a fee for services or to increase fees where current rates were out of date. The Department's comment on our observation was that draft procedures had been prepared for implementation in 1975. Although the Department issued a cost recovery policy in 1979, no major new specific cost recovery initiatives were proposed until 1982. Negotiated agreements were postponed when the anti-inflation (6 and 5) regulations were introduced.

6.67 In 1984, the Department prepared an overview of cost recovery opportunities. This resulted in setting a target to increase cost recovery by $25 million for agricultural inspection services and $5 million for research activities. These targets have not yet been met.

6.68 Progress on cost recovery initiatives has been made since 1984:

- negotiating cost recovery agreements for various activities, including fresh fruits and vegetables inspection and livestock grading;
- developing a cost recovery strategy for Food Production and Inspection activities;
- revising cost recovery targets; and
- issuing a new departmental policy on cost recovery in the fall of 1986 that each Branch will have to translate into operational terms.

6.69 The first step in implementing the policy is to identify the Department's authorities for cost recovery and to assess the trade-off between cost recovery opportunities and program prerequisites. Then, specific services and activities can be identified for which costs should be recovered. The Food Production and Inspection Branch has made progress in gaining acceptance of cost recovery as a way of doing business. Various activities in the fields of quality assurance and animal and plant health are now subject to cost recovery but at a rate slower than original estimates. Additional cost recovery options are also being pursued, and we have been told that, by 1990, future cost recovery will be directed to full recovery of those costs which, in the opinion of the Department, should be borne by industry.

6.70 Despite the $5 million annual cost recovery target established in 1984, subsequently revised to $1.1 million per year in 1987, the Research Branch is still only starting to look at cost recovery options. Some potential cost recovery areas have been identified but formal proposals still have to be developed. The level of potential recovery reported so far is small. However, the Branch has not performed a cost-benefit analysis of the areas where cost recovery could apply.

6.71 Once a decision has been made to recover costs for a given service, the costs of providing that service should be identified. The Department should then determine which costs and what proportion of them should be recovered. Cost recovery rates can then be developed on the basis of anticipated costs and levels of service. Although the Food Production and Inspection Branch has established costs in respect of recent cost recovery agreements, it has not formally documented methodology for establishing rates to ensure completeness and consistency. For example, there is no standard definition of the types of costs on which fees are to be based, and there is no specific requirement to forecast costs and service levels in setting future rates. Also, criteria to assess the ability of industry groups to absorb fees over time have not been formalized.

6.72 The departmental policy on cost recovery states that "the review and possible adjustments of rates should be done on a regular basis (annually at minimum)...". The process for negotiating with industry, approving and implementing rates is a long one. Costing and management information systems for cost recovery will have to be improved in order to make a regular review of rates possible. The Department is not yet able to report systematically where rates under existing agreements are out of line. The Food Production and Inspection Branch has resource data available that can be used to report information on current costs and actual cost recovery by type of service.

6.73 **Once authority for cost recovery has been established and opportunities have been approved, the Department of Agriculture should**

- **formalize and document costing and rate setting policies and methodology for new cost recovery initiatives;**
- **use current and forecast cost data in rate setting for future agreements; and**
- **review the need for complete cost information and put systems in place to monitor cost recovery performance.**

***Department's response**: The Department will, by March 31, 1988, incorporate changes to its existing cost recovery policy to more comprehensively address costing and rate setting methodologies and the use of current and forecast cost data. By March 31, 1988, the Department will have completed a review to define the types of costs on which fees are to be based. The responsibility to monitor cost recovery performance on a departmental wide basis has been formally assigned to the Resource and Program Review Committee.*

Information Management

6.74 The Systems and Consulting Directorate is responsible for providing electronic data processing systems and services. The Department maintains an infrastructure of over 3,000 micros, word processors and terminals, 45 mini- computers and 1 mainframe interconnected by a country-wide telecommunications network. The systems plan for 1986 identified expenditures of $50 million and 385 person-years for activities related to information systems.

6.75 We have two findings in this area. First, the Department's financial management information system has served financial accounting needs reasonably well, but it is at some risk. Second, there is inefficient use of management information resources.

6.76 The Financial Allotment Control System (FACS) is the Department's primary financial management information system. Over 150 responsibility centres are served by 90 terminals for entering and extracting financial information. The system is estimated by the Department to cost $2.3 million a year to operate.

6.77 FACS was intended to assist managers in financial and person-year control and in resource allocation. The system, which is owned and managed by a service bureau, was introduced in 1983 and went into full operation on 1 April 1984. The renewed service contract was effective on 6 December 1985 and runs until 31 March 1988 with an option to extend the contract for one additional six- month period.

6.78 There is risk that the system to replace FACS will not be ready before the present service contract ends. A departmental systems feasibility study estimated it would take 24 months to introduce the replacement system, assuming it started by January 1987. At the time of our study, no extension to the service contract had been negotiated, and only 13 months remained to March 1988 for system replacement.

6.79 FACS was built for obsolete hardware and design limitations contributed to delays in management financial statements, service disruption, manual control of allotments and data corrections. As early as April 1985 FACS was known to have shortcomings and did not meet all user requirements. Poor machine performance has sometimes resulted in a move away from some of the system's functions. For example, a key mechanized processing control was eliminated. Other requirements were reduced to accommodate the system.

6.80 The service bureau has no extended interest in FACS. It has abandoned attempts to transfer the system to other hardware, has not augmented support resources and has declared its intention to drop the system on termination of the contract. Although efforts are under way by the Department to replace FACS, the reliance on contracted resources, the tightness of the replacement schedule and the magnitude of the project all have risk and cost consequences for the Department.

6.81 Inefficient use of management information resources within the Department is indicated by:

- duplication of financial systems development and data entry;
- maintenance of informal financial records to compensate for the shortcomings of FACS;
- not enough people allocated to work with the large amount of processing capacity of the in-house computer facility;
- a major backlog in systems development, including a system to isolate the costs of maintaining and operating capital facilities; and
- lack of information on the current allocation of information resources across the Department in relation to priorities and work loads.

6.82 The Department of Agriculture should review the allocation of its information resources to ensure that priorities for management information are being met economically and efficiently.

> ***Department's response**: The Department concurs with the recommendation and actions have already been taken to reorient and reallocate resources in support of information systems. An ongoing review of priorities and resources has been established to ensure the efficient use of available resources.*

Information in Part III of the Estimates

6.83 Our 1986 comprehensive audit of the Department reported opportunities to improve the Department's disclosure of performance measurements for accountability purposes. In terms of financial information, we note that the Main Estimates for 1987-88 made only a footnote reference to the $700 million in transfer payments under the Special Canadian Grains Program and did not disclose the estimated $1.4 billion deficit in the Western Grain Stabilization Fund.

6.84 We found it difficult to determine the total cost of all federal agriculture programs. This information is scattered in the Estimates of several departments and the annual reports of several Crown corporations. We believe it would be useful to draw this information together and present a consolidated picture to Parliament. This could be done in the Main Estimates or in the annual report of the Department of Agriculture. Exhibit 6.5 is an illustration based on information we have been able to gather, but it is not necessarily complete.

Exhibit 6.5

ILLUSTRATION FOR THE DISCLOSURE OF FEDERAL PROGRAMS IN AGRICULTURE

	1986-87 ($ millions)
Agriculture Canada	
Transfer payments	933
Special Canadian Grains Program	296
Western Grain Stabilization Fund payouts	859
Research, inspection, administration, operations and capital	687
	2,775
Transport	
Payments to railway companies for western grain transportation	706
Health and Welfare	
Food safety, quality and nutrition	31
External Affairs	
International trade development - grains and food	16
Regional Industrial Expansion	
Developments under Agricultural and Rural Development Act	22
Employment and Immigration	
Farm Labour Pools - Employment Development	7
Canadian Wheat Board deficits to 31 July 1986	201
Farm Credit Corporation losses	125
Crop Insurance payments	320
Fuel rebates	96
Reduction in seaway toll on grains	2
Freezing of Canadian Grain Commission tariffs	20
	$ 4,321

Notes: 1. The amounts do not include measurement of tax expenditure benefits such as deferred capital gains on farm property transfers, accelerated capital cost allowances and full deductibility for land improvement costs in one year.

2. Also not included are interest and financing costs for certain loans receivable by the Canadian Wheat Board, on which little or no repayment has been received in recent years or is likely in the foreseeable future.

6.85 The Department of Agriculture, in co-operation with other involved departments, agencies and Crown corporations, should provide a consolidated statement of the cost of agriculture programs. Part III of the Estimates for the Department should give visibility to all upcoming expenditures and commitments regardless of how they are to be funded.

Department's response: *The Department does not concur with the recommendation to incorporate the costs of agricultural related programs from other ministeries within its Annual Report. Ministers should remain accountable for their respective expenditures appropriated by Parliament. In addition, it would be difficult to provide complete assurances that the information would be all-inclusive, including tax benefits.*

The Department fully supports the provision of a comprehensive picture of Agriculture Canada expenditures and commitments in Part III of the Estimates.

Initiatives were taken in the 1986 Part III to improve the information display for special accounts such as the Crop Reinsurance Fund and the Western Grain Stabilization Account. As circumstances warrant in the future, the Department will continue to seek opportunities to provide more comprehensive information on expenditures and commitments both with regard to continuing programs and to individual initiatives.

DEPARTMENT OF ENERGY, MINES AND RESOURCES

DEPARTMENT OF ENERGY, MINES AND RESOURCES

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7

DEPARTMENT OF ENERGY, MINES AND RESOURCES

Departmental Overview

7.1 Energy, Mines and Resources (EMR) is a large and diverse department with 4,744 person-years, $711 million in annual expenditures, and over $100 million annually in revenue, as shown in the 1987-88 Estimates. It has two main responsibilities: the Energy Program, and the Mineral and Earth Sciences Program, both supported by the Administration Program.

7.2 The scale of the Mineral and Earth Sciences Program has increased over the past four years, with annual expenditures rising from $264 million to $333 million since 1984-85, in part because of the increase in the number of federal-provincial mineral development agreements. But the scale of the Energy Program has declined significantly over the same period, with expenditures falling from $2.800 million to $333 million, due mostly to the termination of some contribution payment programs. The Administration Program, with a budget of about $45 million, has remained relatively constant.

7.3 This year we examined financial management and control in the Department and followed up previous recommendations on electronic data processing.

Financial Management and Control: Scope of Study

7.4 Financial management means departmental managers should make decisions knowing their financial implications, manage operations with due regard for economy, efficiency and effectiveness, and provide information so they can be held accountable for their use of resources.

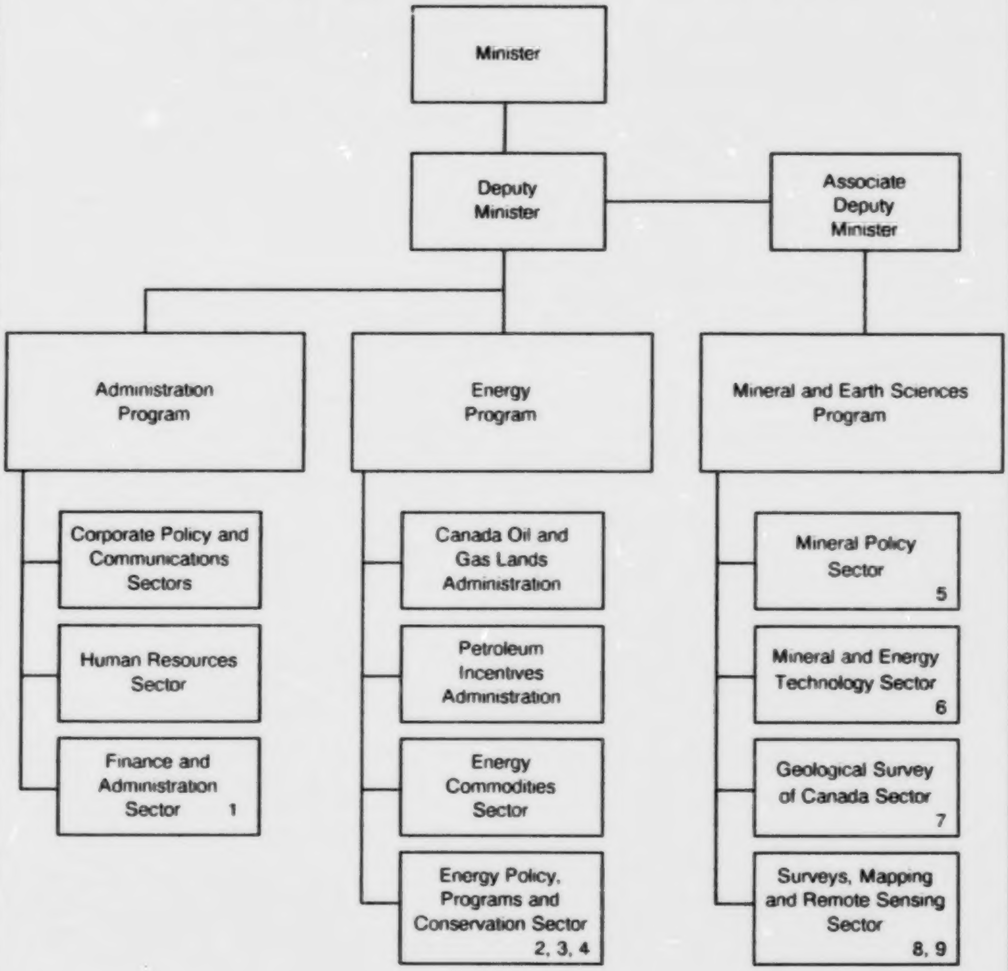
7.5 Financial control means that assets held by a department are properly recorded and protected, accounting data are accurately and reliably maintained, and expenditure of funds is restricted to the purpose intended and limited to the amounts approved by Parliament.

7.6 We examined financial management and control in EMR as they apply to the normal management cycle of planning, budgeting, budgetary management and control, and reporting. We paid particular attention to planning and reporting which are the cornerstones of financial management.

7.7 Our examination relied on information obtained from our Office's recent value-for-money audits and annual attest audit work. It also relied on the work and the reports of EMR's Internal Audit Branch. In addition, we carried out examinations in nine specific units of the organization in order to confirm the information obtained from other sources and assess the

Exhibit 7.1

DEPARTMENT OF ENERGY, MINES AND RESOURCES ORGANIZATION CHART INDICATING THE AREAS EXAMINED


Minister
Deputy Minister
Associate Deputy Minister
Administration Program
Energy Program
Mineral and Earth Sciences Program
Corporate Policy and Communications Sectors
Human Resources Sector
Finance and Administration Sector 1
Canada Oil and Gas Lands Administration
Petroleum Incentives Administration
Energy Commodities Sector
Energy Policy, Programs and Conservation Sector 2, 3, 4
Mineral Policy Sector 5
Mineral and Energy Technology Sector 6
Geological Survey of Canada Sector 7
Surveys, Mapping and Remote Sensing Sector 8, 9

Units Selected For Examination

1. Technical Field Support Services, Administrative Services Directorate
2. Energy Strategy Branch
3. Industrial Energy Programs, Energy Conservation Branch
4. Technology Transfer and Demonstration, Energy Conservation Branch
5. Mineral Strategy Branch
6. Energy Research Laboratories, CANMET Energy Technology Branch
7. Mineral Resources, Continental Geoscience and Mineral Resources Branch
8. Canada Centre for Remote Sensing
9. Map Reproduction and Distribution

current state of financial management. These units represent about 10 per cent of all departmental units and about 20 per cent of EMR's current expenditure budget. They are identified in Exhibit 7.1.

7.8 For an explanation of key terms used in this chapter, refer to Exhibits 4.6 and 4.7 in Chapter 4.

Overall Assessment of Financial Management and Control

7.9 We found both strengths and weaknesses in financial management and control in EMR.

7.10 At the corporate level, the information available to plan, manage and report on operations is not sufficient. The Operational Plan Framework does not specify intended results. This is partly because of the difficulty in aggregating the wide variety of tasks found in each activity into overall results measures. Consequently, at the corporate level, EMR cannot link resources to expected program results. Nor are resource levels for ongoing activities critically challenged each year in relation to the level of service or work anticipated.

7.11 At the branch level, the information in work plans and progress reports compensates for some of these short comings. These plans generally link resources to specific projects or outputs and provide a reasonable basis for managing EMR's operations and for establishing internal accountability. This applies particularly to the larger contribution programs EMR has managed over the past four years.

7.12 There are inconsistencies in the quality of information used to plan, manage and report on new initiatives.

7.13 Accountability to Parliament has been improved but not fully achieved through Part III of the Estimates. The Part III does not disclose intended results for each EMR activity or provide sufficient linkage between resources and results. Nor does it disclose the extent to which program objectives have been achieved with the resources previously provided. Although information is often available to do so, EMR seldom defines measurable goals in Part III or indicates how long funding will be required before targets are achieved.

7.14 There have been significant improvements in financial control since our 1974-76 government-wide study. Existing financial controls within EMR provide reasonable assurance that public funds are protected and that accounting records are accurate and reliable. They also provide reasonable assurance that money is spent for the purposes intended and that spending is limited to the levels approved by Parliament. However, controls over equipment assets require improvement.

Financial Management

Information for Planning, Managing and Reporting on Operations

7.15 **Operational Plan Framework.** The Department's Operational Plan Framework (OPF) provides the basic structure for planning, resource allocation and management. This framework subdivides EMR's three programs into 18 activities which are further subdivided into about 100 sub-activities.

7.16 EMR developed its OPF in response to central agency guidelines and initiatives. The completed document was intended to provide the basis for justifying resources at the activity level by linking requested resources to expected results. The OPF identifies objectives for each activity and establishes the basis for allocating resources to these activities on an annual basis. However, as explained in the OPF:

> Separate results statements are not described in order to reduce the distance from their inseparable objectives. Instead, the focus of management is on the accurate setting and articulating of objectives. The aim is to state objectives in such a way that, whenever possible, they would include the results expected.

7.17 Nevertheless the objectives do not clearly identify explicit, measurable results. For example, the objective of the Mineral and Energy Technology activity is "to ensure the availability to Canada of optimum technology for the extraction, processing and utilization of mineral and metal resources." This statement is too vague to be used as a basis for resource allocation. It does not provide descriptions of key results, such as specific technologies to be transferred to particular industries. Although the statement suggests a level of service by using the term "optimum", it does not indicate what EMR considers the optimum technology level to be.

7.18 One problem in describing results lies in the breadth of work within this and most other EMR activities. In this case, Mineral and Energy Technology includes such disparate work elements as research in several different fields, policy analysis and development, service delivery and administration. The results from each of these are measured in different ways. When aggregated into one activity, no overall measure can be applied.

7.19 **Where possible, the Department of Energy, Mines and Resources should develop clear statements of results for each program activity.**

7.20 **Departmental budgeting.** EMR uses prior year's costs as the basis for estimating base resource levels for ongoing functions. When new initiatives are added to activities or existing ones eliminated, management prepares estimates of the impact on resource levels. Our findings related to new initiatives are reported separately in this chapter.

7.21 For ongoing functions we found little evidence that resource levels were critically challenged by corporate management or analysed by staff in the central planning or finance groups on an annual basis. When faced with requirements to reduce the Department's budget, or fund a new activity from existing resource reference levels, corporate management does examine potential opportunities to effect savings. In doing so, however, information such as the level of service or work anticipated in relation to resource levels, was generally not requested or provided.

7.22 **Corporate management in the Department of Energy, Mines and Resources should ensure that the level of resources requested in relation to the level of service or work anticipated is challenged within each ongoing function in EMR.**

7.23 **Branch work planning.** Once resources are obtained from Treasury Board, managers finalize detailed plans. Branch managers build up plans for each of their programs, projects or sub-divisions, as the case may be. These plans typically include a statement of goals and a description of major planned activities, milestones and outputs. Project proposals normally form the basis for the branch work plan. These proposals describe specific endeavours that will be undertaken during the year, the milestones and outputs that will be used to assess achievement, and an estimate of the resources required.

7.24 We found that planning at the branch level normally links resources to expected outputs and, through the use of project proposals, provides a reasonable basis for budgetary control and for holding managers accountable for achieving their work plans.

7.25 **Managing operations.** Our examination of information for managing operations focused on the control of contribution funds. We selected this area because in the past four years EMR has spent over $6 billion on contributions. This represents 80 per cent of EMR's total expenditures over this period.

7.26 We expected to find clear criteria identifying who should receive contributions and for what purpose. In addition we expected to find effective financial control procedures and a means for determining whether funds provided were, in fact, used for the purposes intended. We found that managers generally have adequate systems and practices to control expenditures. For example, in the Petroleum Incentives Program and the Oil Pricing and Compensation Program, applications for contribution funds were evaluated against criteria established through enabling legislation and regulations. Payments were not authorized unless an approved application is present and recommended for payment. Subsequent to the payment of funds to applicants, audits were conducted to ensure that applicants comply with the terms and conditions under which their applications were approved. Line managers kept detailed information on the amounts paid to applicants and on the status and results of subsequent audits.

7.27 Even though appropriate control mechanisms are in place, they do not always work. In our annual audit work we have identified instances where ineligible payments have been made and not recovered. A case in point involves the Forest Industries Renewable Energy Program. In 1984 it was identified that ineligible payments amounting to $451,982 had been made to an applicant under this program during 1983. The error was brought to management's attention in 1984. No attempt to rectify this matter was made until 1986. At the time of our examination, this matter remained unresolved.

7.28 We also examined information available for general budgetary management and control. Responsibility for this is delegated to line managers at EMR. In our study we focused on line managers who are typically in charge of a project, division or branch. We found that these managers have sufficient information available to assess the extent to which they are accomplishing their work plans.

7.29 Because performance measures were generally not available during the budgetary challenge process, we did not find much performance measurement information being used to manage operations. Instead, we found information concerning progress toward achieving the work plan, and information that enables managers to control their budgets.

7.30 We found that line managers obtain information from a variety of sources. Financial data is provided by the central financial system (FAMIS) and frequently supplemented by additional financial data from branch systems. Operational data such as output statistics and administrative control information are normally obtained from branch systems designed to meet the specific information needs of branch users. By combining data from their own systems and the central financial system, line managers can assess the extent to which they are accomplishing their work plans.

7.31 For example, the Director of the Industrial Energy Programs Division of the Energy Conservation Branch receives financial reports that identify expenditures compared to budget. Other sources provide indicators of achievement, such as the number of applications screened, estimates of the amount of energy to be saved, and the number and types of contributions paid. Financial and operating data together allow the Director to assess the status and compare it to the work plan.

7.32 **Reporting within EMR**. Given the limitations identified in the OPF and in the annual budgetary challenge process, we did not expect to find internal reporting on the extent to which the objectives stated in the OPF were achieved or on the extent to which operations were carried out with due regard for efficiency.

7.33 Instead we reviewed the reporting structure to determine the accountability relationships and then examined the information contained in management reports. We looked for information that would demonstrate whether the plan was being achieved with the resources provided and if not, why not.

7.34 We found that reporting relationships are clearly defined, and that line managers had an adequate information base relating to planned activities. However, EMR's management reports alone do not convey sufficient information to senior management regarding the extent to which branch work plans are being achieved. This problem is similar to the one of aggregating work elements into activities, described previously. As project information is merged and summarized, important details can be lost. Senior management holds periodic accountability sessions with key branch staff to compensate for this.

Information for Planning, Managing and Reporting on New Initiatives

7.35 We reviewed internal and publicly available documents in order to select new initiatives for examination. We did not attempt to follow the process of challenge and analysis faced by each expenditure proposal in the Department and at Treasury Board Secretariat, but instead examined the final version of the information supporting those initiatives that had passed successfully through the process. Our examination included a major capital project, a long-term change in program direction, and an internal administrative project.

7.36 We expected to find sufficient, appropriate information on the estimated cost of each initiative, the expected results, a timetable for completion, and a framework for managing its implementation. In our opinion the information base for initiatives was often inadequate. For the major capital project, the essential information elements were present. For the other initiatives they were not.

7.37 For example, the Surveys and Mapping Branch is undergoing a major change in program emphasis from data gathering to data management. Over the next decade the Branch will increasingly use computerized data base management and computer graphics hardware and software to develop national digital data bases of geodetic positions, topography of the terrain, aeronautical navigation data for air safety, National Atlas information, and digital files for the management of Canada Lands, including those in the offshore. This initiative will require, among other things, a larger investment in capital and a major retraining of staff. The components and costs of these changes affect virtually the whole Branch, and the capital costs alone have been estimated by EMR to exceed $15 million.

7.38 The information available for this initiative establishes a 10-year timetable for completion and identifies the expected results. But according to a recent study completed by EMR's Internal Audit Branch:

> In recent years, the Surveys and Mapping Branch has been the subject of a succession of internal and external reviews. In attempting to respond to the various recommendations arising from these reviews, and to address the requirements of numerous other issues and priorities imposed upon it, the Branch has become largely reactive, to the point that its ability to plan on a long-term basis has become seriously impaired.

In the opinion of the internal auditors:

> ... it is now critically important that the Branch be accorded sufficient stability and latitude to develop and implement an effective long term plan, which will ensure that the necessary human and physical resources will be available to meet the longer term organizational and operational objectives established and approved for the Branch.

In our opinion, this study raises some doubts about the adequacy and completeness of the implementation plan and the cost estimate for this initiative. Without this information, progress toward accomplishing the initiative cannot be accurately monitored, and branch management cannot be held financially accountable.

7.39 A further example: in the past three years, the Financial Management Branch has budgeted $300,000 to upgrade the Financial and Managerial Information System. Because of the cost, time and uncertainty involved in custom re-building, and because of developments in packaged software, EMR decided to buy software to meet its needs. The Branch's "Report on the Planned Redesign of the Financial and Managerial Information System (FAMIS)" outlined alternatives and recommended an approach. In early 1987, EMR purchased a software package called the "Government Financial System".

7.40 Planning for this initiative included an estimate of major cost components, a description of expected results and a date for completion. The planning focused primarily on the responsibilities of the Financial Management Branch. Yet successful accomplishment of this initiative depends on the involvement of other branches. The Computer Science Centre, for example, must provide the necessary computing and communications ability for the system, and user branches need to provide a system input capability. The potential costs to these branches have not been included in the project estimates. Nor has their responsibility been clearly established with respect to ensuring that this initiative is accomplished on time and within budget.

7.41 In both these examples, additional cost and planning information would have enabled senior management to make a more informed decision about the initiative and its implementation timetable. Additional information could also have provided a more complete framework to hold managers accountable for accomplishing these initiatives within budget.

7.42 **The Department of Energy, Mines and Resources should establish guidelines respecting the nature and extent of financial and operational information required to support both decision - making and reporting on new initiatives.**

Accountability to Parliament

7.43 Since 1983, EMR has prepared Estimates Part III using guidelines established by central agencies. We reviewed the information published in Part III for the past four years in order to determine whether EMR's plans and accomplishments were adequately disclosed.

7.44 Almost without exception we found that new spending initiatives, such as those described in the previous section, were not described consistently or adequately in Part III. Thus no basis was provided for Parliament to judge whether the initiatives would provide value for the money requested.

7.45 Part III provides charts, figures and descriptive detail. Resource requirements are stated in terms of dollars and person-years. Resources and their intended use are described beginning with departmental programs, then activities associated with each program, and finally sub-activities associated with each activity. The sub-activities disclosed in the 1987-88 Part III vary in size from $146,000 to $133 million and from 2 person-years to 246 person-years. We concentrated on the adequacy of sub-activity descriptions, where detailed information is provided.

7.46 Exhibit 7.2 shows the goal and significant planned outputs and results of the Energy Conservation sub-activity in the Energy Program. This example indicates a general problem with the Estimates Part III. It seldom defines measurable goals or says how long funding will be required before targets are achieved. Nor does it state what immediate results are expected from the resources requested or how much specific results or outputs are likely to cost. For example, although the goal of the Energy Conservation sub-activity is to increase energy efficiency, no target or target dates are stated.

7.47 The description indicates that $42 million and 98 person-years will be used to further this energy efficiency goal by producing 11 significant results or outputs. Of the 11, only 1 (highlighted in Exhibit 7.2) provides an indicator of expected volumes. The rest indicate action, but not its extent. The narrative does not say whether the resources will be used evenly or whether some significant outputs will require more resources than others.

7.48 Much better information is usually available in EMR's branch and division work plans. We believe that some of this "internal" accountability information could be used to improve the Part III.

7.49 **Where possible, the Department of Energy, Mines Resources Estimates Part III should state target dates and quantities for sub-activity goals, and expected costs, target dates, and quantities for each significant planned output and result.**

7.50 We also looked at how Part III described EMR's achievements in relation to the money voted by Parliament in previous years. We found that information was often inadequate, inconsistent and, in some cases, completely absent.

7.51 For example, Exhibit 7.3 shows how the Propane Vehicle Grant Program has been described in the Part III over the past four years. This $38 million program is disclosed as part of the Transportation Vehicle Fuels Sub-activity, but the bits and pieces of information provided in various places do not fit together. They present an apparent contradiction in target volumes and target dates. They do not show how annual resources contributed toward achieving the purpose of the program or whether the target level of conversions to propane power had been reached at the termination of the program.

7.52 This is an example of poor disclosure of plans and progress. It is typical of a general problem with EMR's Part III. It does not establish an informative base for accountability or demonstrate the extent to which EMR has accomplished what was intended.

7.53 **The Department of Energy, Mines and Resources Estimates Part III should include a specific accounting of the extent to which expected "significant outputs and results" have been achieved.**

Exhibit 7.2

HOW PLANS ARE DESCRIBED IN PART III OF THE ESTIMATES
Extract from Page 3-37 of the 1987-88 Part III

Energy Conservation Sub-Activity

Goals: To develop and implement policies and programs to increase energy efficiency in all end-use sectors in close co-operation with the provinces, territories and the private sector, with particular emphasis on technology development and transfer, industry development and consumer education.

Significant Planned Outputs and Results for 1987-1988:

- Providing a comprehensive, timely, quality consumer education program to increase public awareness of the benefits of implementing energy conservation, using market research, target marketing, information dissemination, telephone "Heatline" energy service and energy audits.
- Identifying opportunities for improvements in energy efficiency in industrial, commercial, institutional sectors and in federal governmental departments, including establishing energy efficiency standards and providing financial assistance for consulting advice.
- Working closely with industrial and commercial task forces, to assist in identifying energy waste and undertaking corrective measures to reduce energy consuption and costs. The major objective is to achieve a high degree of energy efficiency in manufacturing and processing sytems.
- Introducing, through R&D and Demonstration, new processes and systems of improved energy efficiency.
- Developing energy management plans to assist governmental departments to meet their energy efficiency goals by providing services such as surveys, training, information dissemination and demonstration projects.
- Implementing revised training programs for housing industry to promote construction of super energy-efficient housing (SEEH).
- **Supporting construction of demonstration homes (500), and certification of houses (2000) under the SEEH program.**
- Expanding the retailer training programs for building supply dealers, as well as extending the number of point of sale displays in Quebec and Ontario.
- Undertaking government-industry co-operative efforts to increase the energy efficiency of house renovations and to upgrade the consumer services avilable from heating systems contractors.
- Fostering the development of a knowledgeable and credible industry capable of applying energy management technology without adversely affecting residential, industrial or commercial building stock or the health of Canadians by:
    - developing an energy management and technology transfer program with energy task forces, trade associations, utilities and provinces;
    - finding eligible R&D projects to develop energy-efficient products and processes, and provide financial contributions for demonstration activities;
    - assisting the residential energy retrofit industry to upgrade its services to the householder through a variety of activities, including training, technology transfer and warranty programs;
    - undertaking research studies to address technical concerns related to the implementation of energy conservation measures such as excessive moistures and air quality.

Exhibit 7.3

POOR DISCLOSURE OF PLANS AND PROGRESS IN PART III OF THE ESTIMATES

Propane Vehicle Grant Program

Duration:	1981-85
Costs:	$38 million (estimate 1981)
Planned Outputs:	Convert 100,000 vehicles to propane fuel

Information in Part III of the Estimates

The first references to the Propane Vehicle Grant Program appear in the 1984-85 Part III. The program is mentioned twice. The first reference, page 3-36, includes the objective of the program in describing the goal of the Transportation - Vehicle Fuels sub-activity. It states:

> "To ensure the orderly development of alternative non-petroleum liquid and gaseous fuels; to replace five per cent of gasoline use by 1990. (By March 1987 goals include 150,000 propane vehicles, 35,000 vehicles powered by compressed natural gas, and the establishment of 125 compressed natural gas fuelling stations)."

The second reference, page 3-72, outlines the origin and intent of the program. It states:

> "The objective of this program is to have 100,000 vehicles using propane in Canada by 1985. This will displace an estimated 2,060 m^3 of oil per day which is currently being used to produce gasoline. The program is on schedule. It was launched in June 1981 and has a $38 million budget over five years to provide taxable contributions of $400 per vehicle. The program is co-ordinated with the Federal Propane Vehicle Program for converting federal government vehicles."

The 1986-87 Part III contains a final reference to this program. It appears under the heading of Update on Previously Reported Initiatives on page 3-26. It states:

> "....; termination of the Propane Vehicle Grant Program (PVGP) on March 31, 1985."

OAG Comments

At the date of our examination, the Part III has not disclosed how many vehicles were converted under this program or at what cost. The discrepancy in goals and target dates of 100,000 vehicles by 1985 or 150,000 vehicles by 1987 has not been clarified in subsequent editions of the Part III.

Financial Controls

7.54 Our examination of financial controls relied on our previous audit work and that of EMR's Internal Audit Branch. We reviewed the findings and recommendations from the internal audits of nine branches or divisions audited in the past two years as part of the Branch's cyclical coverage of the Department. We also examined the results of monthly compliance tests of expenditures that the Branch had conducted during the same period.

7.55 Internal Audit has not identified any significant control weaknesses in revenues and expenditures. It did find problems related to assets. Because EMR's assets include an estimated $150 million in equipment, we conducted our own random examination of equipment records and control procedures to determine whether similar weaknesses existed. In one instance we identified five vehicles costing about $100,000 each that were not included in asset records. In another instance we found that during 1985 Technical Field Support Services could not complete verification procedures on about 20 per cent of its equipment because users of the equipment failed to confirm its whereabouts.

7.56 During our examination of equipment records we also looked for evidence that equipment usage was being monitored. We found little indication that branches responsible for equipment were systematically monitoring its use.

7.57 We concluded that existing controls do not provide reasonable assurance that EMR's equipment assets are adequately safeguarded.

7.58 The senior financial officer in the Department of Energy, Mines and Resources should conduct a review of all equipment asset records and related control procedures.

Financial Management Information Systems

7.59 EMR's approach to systems development for financial management information has evolved over the past few years. There is a central, EDP-based system (FAMIS) that is the primary source of departmental accounting information. There are also separate financial systems in many branches of the Department, most of which are dependent on or tributary to the central system. When managers require statistical or other operating information to supplement financial data, however, they are responsible for developing their own systems. Many have done so. Some systems are sophisticated, combining financial and operating data and using microcomputers; others are not. Thus a number of systems of varying degrees of sophistication collectively provide the Department's financial management information.

7.60 This approach provides most managers with the information to control their budgets and to assess whether they are accomplishing their work plans. In some cases, data entry, data storage and databases have been integrated with the central system, but we noted several instances where data entry and data storage were being duplicated. We also noted an instance where the branches developed systems to accomplish similar management information needs. Six branches developed equipment record systems that were designed to perform substantially the same function.

7.61 These observations cast doubt on the overall efficiency of the systems used to deliver financial management information and on the efficiency of the systems development process.

7.62 The Financial Management Branch is taking action to remedy some of these difficulties. However, in doing so it is proceeding without the benefit of a department-wide plan. In our opinion, a co-ordinated approach to financial management information systems development is essential.

7.63 **To minimize effort and duplication the Financial Management Branch of the Department of Energy, Mines and Resources should ensure that there is a co-ordinated approach to financial management information systems development throughout the Department.**

Electronic Data Processing in EMR

7.64 As well as examining the EDP systems related to financial management and control, we followed up on related recommendations 9.108 and 9.110 in our 1982 Report concerning the Department's EDP plans and policies. At that time we could find no evidence of cohesive EDP policies and strategies for supplying computer services or long-range management plans to harness computer technology to meet program needs. We commented on the need for senior management to emphasize these matters.

7.65 Since 1982, many important changes have taken place. The Department's annual EDP budget has increased from $18 million to $50 million and the number of EDP-related staff has increased from 202 to 336 person-years. EMR now has over 50 medium- and large-scale computers, and over 1,300 small computers across the country. During the same period, EMR reassessed the role of its central computer facility, the Computer Science Centre (CSC), and its share of departmental computing expenditures has dropped from 33 per cent to about 20 per cent. Today no single organization in the Department dominates the EDP environment. There are many centres of information technology in EMR's program sectors, a central policy unit and three central service units providing or co-ordinating various EDP-related functions and services.

7.66 We focused our audit work on the Informatics Policy and Planning Secretariat (five person-years) reporting to the Assistant Deputy Minister of Finance and Administration. In 1985 this central unit was given the mandate to prepare an informatics plan pertaining to corporate requirements, and to provide policies for all areas of informatics (EDP, telecommunications and office automation). The Secretariat has issued an Informatics Policy and Strategy for EMR that sets out the framework for co-ordinating informatics in the Department.

7.67 **Information technology planning.** EMR's 1985 framework paper envisioned the need for a new informatics planning process and a new plan, but to date these have not been put into effect.

7.68 A basic management requirement is an overall departmental plan detailing the approach to the development and use of information technology in support of departmental programs, and the expected information resource requirements. What EMR has instead is an annual departmental Information Technology Systems Plan, compiled by the Secretariat as required by the Treasury Board. But it lacks a departmental perspective, a rationale supporting the proposed activities, and sufficient narrative detail. This plan is not considered by Treasury Board, by the Department or by this Office to be an adequate overall departmental strategic plan.

7.69 An overall departmental plan would also increase the co-ordination of the acquisition and use of information technology. One major feature of EMR is that the branches and sectors, not the Secretariat, are in control of the Department's EDP funds and staff, in part because of the varied and heterogeneous functional responsibilities in the Department. As a result, there has been traditionally little department-wide co-ordination of systems architecture, systems development, hardware and software purchasing. Some recent efforts have been initiated by the Secretariat to co-ordinate hardware and software purchasing, but it is too early to judge whether they will be successful.

7.70 **EDP policies and guidelines.** EMR's 1985 framework paper and our 1982 audit both identified the need for policies and guidelines to govern the economic, efficient and effective use of information technology. Although work has been done in a number of significant areas such as telecommunications and office automation, in others work has not yet begun. For example there are no departmental guidelines for developing corporate or large-scale systems, such as financial management systems, that would require feasibility studies, consideration of training and other human resource aspects, and post-implementation reviews. In our opinion, these remain urgent priorities, partly because of the problems in financial systems development we noted earlier.

7.71 Although the Secretariat has a mandate to implement departmental informatics policies, it has no specific mandate to monitor them, and it does not do so. No organization has a mandate to monitor EMR's adherence to central agency informatics policies.

7.72 **Conclusion.** The rapid increase in the number of computers and computer users and the advances in information technology since our 1982 Report have amplified the need we noted then for senior management attention to economic, efficient and effective use of EDP. We found that EMR lacks a central focal point with a sufficient mandate either for effective informatics planning or for establishing and monitoring all informatics policies. Stronger co-ordination does not necessarily mean central control over informatics, but, as a minimum, we suggest that information technology warrants more attention at the senior management level.

7.73 **The Department of Energy, Mines and Resources should enhance leadership over information technology by preparing a departmental plan, by developing additional departmental policies, and by reporting progress regularly to senior management.**

DEPARTMENT OF EXTERNAL AFFAIRS

DEPARTMENT OF EXTERNAL AFFAIRS

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DEPARTMENT OF EXTERNAL AFFAIRS

Introduction

8.1 Our audit covered the common administrative services of the Department of External Affairs - Corporate Management, Finance, Property Management, Personnel, Internal Audit, Program Evaluation, Telecommunications and Records Management (see Exhibit. 8.1).

8.2 The common administrative services provided by Headquarters branches use 1,000 person-years and $215 million in annual expenditures, including capital costs. Each mission has its own administration section that is not included in these figures. The Department estimates that in the missions these services use 538 Canada based person-years as well as approximately one-half of the 3,600 locally engaged staff. Thus of the 7,800 people on strength in the Department, almost 3,300 are involved in providing common administrative services.

8.3 This audit was part of our government-wide study of financial management and control.

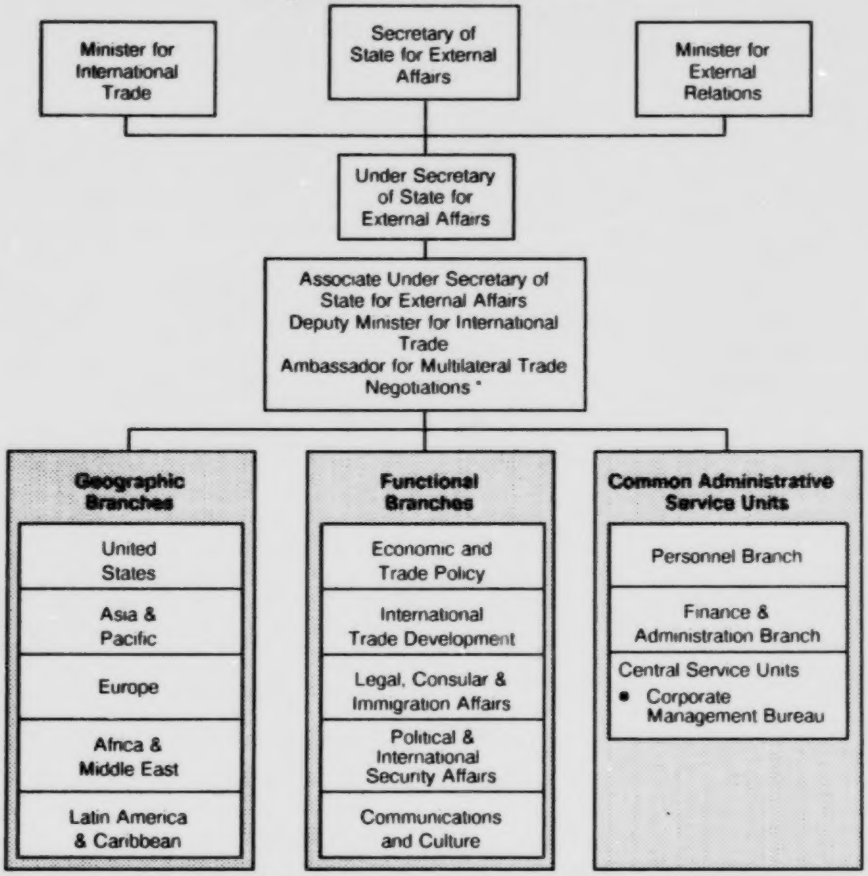
Audit Scope

8.4 The purpose of the audit was to determine whether External Affairs' common administrative services are provided with due regard for economy and efficiency, and are meeting the needs of line managers. We examined:

- the way in which the Department determines its resource needs and allocates resources;
- the financial information available to line managers to assist them in making decisions and controlling operations;
- the quality of financial analysis provided to decision makers when faced with major decisions;
- the management of assets, both monetary and fixed;
- the provision and management of the Department's real property in the form of chanceries, official residences and staff quarters;
- the management of the design and construction of the chancery at Washington, D.C.;
- human resource management as it relates to planning, assigning and training personnel;

Exhibit 8.1

SUMMARY ORGANIZATION CHART


Minister for International Trade
Secretary of State for External Affairs
Minister for External Relations
Under Secretary of State for External Affairs
Associate Under Secretary of State for External Affairs Deputy Minister for International Trade Ambassador for Multilateral Trade Negotiations *
Geographic Branches
United States
Asia & Pacific
Europe
Africa & Middle East
Latin America & Caribbean
Functional Branches
Economic and Trade Policy
International Trade Development
Legal, Consular & Immigration Affairs
Political & International Security Affairs
Communications and Culture
Common Administrative Service Units
Personnel Branch
Finance & Administration Branch
Central Service Units
• Corporate Management Bureau

* Exact title: Ambassador for Multilateral Trade Negotiations and the Prime Minister's Personal Representative for the Economic Summit

- the management and application of the foreign service directives, including a study of leave;
- the management of internal audit; and
- the management of the departmental records and communications systems.

8.5 The audit commenced in April 1986, with field work concluding in April 1987. Our audit included site visits to Santiago, Mexico, Washington, London, Nairobi, and Algiers. We also relied on the Department's recent internal audit reports. Our headquarters activities focused on the Corporate Management Bureau, Finance and Administration Branch and Personnel Branch. This work was augmented by discussions and reviews with personnel in the geographic branches, the Passport Office and the Special Trade Relations Bureau.

8.6 In 1975 we audited the Department as part of our first Financial Management and Control Study. We followed up on those observations in our 1982 audit of External Affairs. We used the 1982 observations as our starting point for this audit.

Financial Management and Control

Financial Management

8.7 Financial management means that decision makers should know the financial implications of their decisions. They should ensure that operations are carried out with due regard to economy, efficiency and effectiveness. Finally, they should ensure that information is available to allow them to be held accountable for their use of resources.

8.8 The main elements of a financial management system include planning, budgeting, budgetary management and control, reporting and financial information systems. The Treasury Board Secretariat and the Office of the Comptroller General require departments to plan what they intend to accomplish and establish a clear linkage between these plans and the resources required.

8.9 Many of the activities of External Affairs are of a policy nature such as the protection of Canadian interests abroad and the conduct of Canada's external relations abroad. It is often extremely difficult to measure these activities and to establish links between the resources and results. We took this into account in our audit.

8.10 The Department of External Affairs has made significant improvement in financial management and control since our 1982 audit. However, there are further improvements required, some of which management is currently undertaking. We elaborate on these in the remainder of the report.

Planning

8.11 Decision makers in External Affairs are generally provided with financial information, appropriate to their environment, concerning the financial implications of major decisions on ongoing operations. For example, financial information concerning the potential savings from the recent mission closures, including the impact on neighbouring missions, was provided to senior managers during their deliberations on how best to achieve such savings. This information was included with other, non-financial, information presented to ministers for final decision.

8.12 The planning process includes determining what should be accomplished and how it will be done. External Affairs has an elaborate operational planning system that requires all managers to develop objectives, action plans and resource requirements and to monitor progress. However, there are some improvements to the planning process that the Department needs to make including:

- developing alternative management strategies;
- ensuring that operational plans are precise enough to be used for managing the activities;
- monitoring the implementation of plans and the achievement of the objectives included in the plans; and
- developing better information systems for materiel planning.

8.13 The development of alternative management strategies is a process of determining if an objective could be better achieved through a different delivery procedure. Fundamental changes to program delivery are not easily implemented and need to be considered well in advance. We found that the Department has not considered alternative delivery mechanisms at the program level. This development of alternatives is now being addressed in the Department's Long Range Management Plan. Managers are being asked to look at alternative ways of delivering the program to achieve cost reductions. Tangible results have yet to appear.

8.14 Not having a plan that identifies alternatives could limit the Department's ability to respond to its rapidly changing environment. An example, which we discuss in more detail later in this chapter, is the need to change delivery procedures because of budget limitations. The cost of accommodation for program purposes is growing while budgets for official entertainment remain stable or decline. An assessment of alternatives might have suggested, for example, more modest housing in some locations, with official entertaining being conducted outside the home.

8.15 In some instances plans may need refining to be more specific and precise. Planning is a continuous and iterative process. Ideas and details need to be elaborated to develop agreed courses of action and to evaluate alternatives.

8.16 The Department had not done this refining of plans in some cases and in other cases the plans were not complete. An example of incomplete planning was the Department's plan to install a computer for processing import permits. The plan did not take into consideration the time required to prepare the site. This resulted in the computer being stored for six months until the site was ready. We estimate the opportunity cost of acquiring the computer early at $50,000. Even after the site was accepted, there was a further delay of five months while air conditioning and equipment malfunction problems were sorted out. Expected savings of $725,000 were not realized during this period because processing continued at a service bureau. (See Audit Note in Chapter 3.)

8.17 We observed other instances where departmental plans were deficient, in that the full impact of operational changes were not always reflected in internal approval documents and submissions to the Treasury Board. Another example was personnel planning, where there was insufficient information on the skills required, or those available, to perform current and future jobs.

Budgetary Management and Control

8.18 The Department is gradually introducing systems to monitor the implementation of plans. The Trade function, consular program, immigration function and Passport Office have developed reasonable means to monitor adherence to plans. The Department has indicated that formal systems for the political, economic, and cultural functions will be introduced in 1988. Until such systems are introduced throughout the Department, management will not be informed regularly and promptly about the achievement of plans, or areas where increased attention is required.

Financial Information Systems

8.19 Financial information at External Affairs is produced on three different systems: the Departmental Reporting System operated by Supply and Services Canada; the Financial Management System operated by the Department; and "black book" systems developed and operated by local managers. This mix of systems has evolved over time to meet the various needs expressed by managers. A knowledgeable user can extract most of the financial information needed by using a combination of the three systems. However, having three systems poses problems in terms of data compatibility, duplication and aggregation of information. A lot of time is spent reconciling the various systems. The Department is introducing a new financial management system (FINEX) to meet its needs and to eliminate the need for the other departmental systems.

8.20 The current arrangement, although less efficient than an integrated system, meets most managers' needs for information for financial control purposes. It does not, however, do some things that would normally be expected of a financial reporting system. In External Affairs most of the expenditures are fixed and not controllable in the short term. Thus managers focus their attention on ensuring that allotments are not exceeded. Where there are expenditures that are controllable and variable, managers set up "black book" systems to determine variances and take corrective actions. The control systems associated with the construction of the Washington chancery provide a good example of this type of reporting.

8.21 The Department budgets to the level of the missions and the responsibility centres at headquarters. Thus functions such as Trade, which includes some mission activities and some headquarters activities, do not have their full budgets associated with them. Once the reporting period is complete, a retroactive allocation of expenditures to major functions is made. This provides senior managers with needed overall information on function expenditures.

8.22 During the planning process senior managers allocate person-years to programs to set the level of effort to be devoted to each program. Program activity levels at missions are best represented by person-year allocations rather than budgets since costs of personnel carrying out comparable functions vary widely according to location.

Passport Office

8.23 The estimating and recording of costs related to mission passport operations for the Passport Revolving Fund which the Department operates was not adequate. The authority for the Fund allows for a $4 million cumulative deficit and requires full cost recovery. To adhere to this authority the Department must ensure that costs are adequately captured and revenue is collected. We observed good revenue collection procedures. But there were some problems with cost allocations. The majority of costs were properly recorded; however, the costs attributed to the mission passport operations were significantly understated, as a result of an inappropriate method of cost allocation. Using information reported by missions on the amount of time devoted to passport operations, we estimate the understatement for 1986-87 could be $1.5 million.

8.24 The Department of External Affairs should ensure that the cost of passport operations at missions is appropriately estimated and recorded in the Passport Revolving Fund.

> ***Department's response:*** *The Department is in the process of developing an appropriate estimate of the cost of issuing passports at missions. The Passport Office Revolving Fund will be charged with these costs to be recovered from passport fees.*

Reporting

8.25 The Department has explained in its Operational Plan Framework and Estimates Part III that, with a few exceptions, it is not possible to clearly link results to resources. We agree with the Department that this attribution of results to resources is difficult for its major programs. The activities of External Affairs require judgement in planning and implementing. Therefore, to the extent practicable, managers should know the relationship between resources used and results achieved to assist them in making those judgements.

8.26 The Department has generally followed, to the extent applicable, the guidelines for preparing Part III of the Estimates, except for the information on capital expenditures. This information is incomplete – only $70 million of the $115 million budget is explained. Not included are minor capital ($32 million) and non-real property projects. Furthermore, the information presented on capital projects does not indicate changes in estimates from prior years. The presentation is limited to projects that have capital demands in the coming year and does not include the costs of projects that were completed. For example renovations to the London chancery were completed in 1986-87, but no mention of the cost is made in the 1987-88 Part III.

8.27 The Department of External Affairs should ensure that the information on capital expenditures presented in Part III of its Estimates is complete and provides continuity with information presented in prior years.

> ***Department's response:*** *Part III of the Estimates will present all schedules required for information on capital expenditures. These schedules will include*

projects completed in the preceding year along with an explanation of any major variances in the estimated cost of projects.

Financial Accounting Control

8.28 Financial control means that assets owned by the government should be properly recorded and protected; accounting data should be accurate and reliable; and funds should be spent only for those purposes stated and within the limits approved by Parliament.

8.29 The Department has in place the internal control procedures to ensure money is spent for the purposes intended and that appropriation levels are not exceeded. We noted, however, that improvements are needed in the processing of accounting information, as described previously, and in the safeguarding of assets described below.

Safeguarding Assets

8.30 Monetary assets include working capital advances to missions, accountable advances to individuals for posting or medical purposes, and security deposits.

8.31 The Department has made improvements in monitoring and following up accountable advances. However, the financial reporting and monitoring of other monetary assets require further improvement. We found many discrepancies and errors in the working capital advances to missions, in records of medical loans to individuals and in security deposits. As well, there was no central register of debentures granting "right of access" to clubs or schools. As noted in our 1986 Report on the Trade Function, accounts receivable for the Program for Export Market Development were not all identified and recorded. The Department has taken subsequent action to resolve the PEMD accounts receivable.

8.32 The quality of financial management of working capital advances to missions varies from mission to mission. The drawdowns at some missions were not related to a reasonable forecast of needs for the coming period. Consequently, missions had more cash on hand than was required. Although some foreign banking institutions will pay interest on these amounts, good cash management would suggest that minimum balances be maintained (see Exhibit 8.2).

8.33 The Department of External Affairs should improve its monitoring and reporting of monetary assets to ensure that records are complete and cash on hand is kept to a minimum.

> ***Department's response:*** *The Department will continue to improve its monitoring and control of monetary assets. Cash management at missions abroad will receive special attention bearing in mind special conditions such as local banking and commercial practices, provisions for emergency requirements, the need to minimize workload and the level of skills of employees.*

Exhibit 8.2

ILLUSTRATION OF WORKING CAPITAL ADVANCES TO MISSIONS ($)

Description	Date	Balance before drawdown	Drawdown	Balance
A) London, UK				
Transactions for September 1986				
Opening balance - beginning of the month				815,691
Drawdown	Sept. 8	496,405	1,000,000	1,496,405
Drawdown	Sept. 23	355,900	1,500,000	1,855,900
Closing balance - end of the month				676,839

Notes:
1) A minimum balance is maintained to cover banking charges.
2) Interest is earned on amounts in excess of the minimum balance.

Description	Date	Balance before drawdown	Drawdown	Balance
B) Washington D.C.				
Transactions for December 1986				
Opening balance - beginning of the month				613,040
Drawdown	Dec. 5	(1,069,634)	3,000,000	1,930,366
Drawdown	Dec. 12	1,094,627	1,000,000	2,094,627
Drawdown	Dec. 22	146,521	1,500,000	1,646,521
Closing balance - end of the month				543,412

Drawdowns on letter of credit are not directly related to a reasonable forecast of needs for the coming period. Consequently, funds on hand are generally too high.

Materiel Supply

8.34 The Department has controls over requisitioning, procurement tracking, inventory in warehouses in Canada, and shipping. They are adequate to ensure compliance with central agency directives. However, surplus materiel is not properly controlled. In one location we visited there was no list of the items that were ready for disposal. In 1986-87, surplus items in this location were eventually disposed of for $20,000. Internal audit has found many instances where missions do not keep records of surplus materiel.

8.35 We also found the headquarters did not have adequate information on vehicles to indicate the number ready for disposal, their location, dates of sale and proceeds from the sales. This information is needed to follow up disposal decisions. During 1986-87 there were 133 vehicles disposed of for approximately $960,000. For the fiscal year 1986-87 total disposal proceeds amounted to $1,496,000.

8.36 The Department of External Affairs should ensure that surplus materiel is properly controlled and records of surplus materiel ready for disposal are maintained.

> ***Department's response:*** *The Department will improve its monitoring of compliance with procedures for the disposal of surplus materiel contained in the Materiel Management Manual. Record-keeping procedures for surplus vehicles have already been amended as a result of the auditor's comments.*

Fixed Assets - Furniture and Equipment Control

8.37 Treasury Board directives call for the establishment of central inventory records of fixed assets and a "custody grid" that shows the required documentation, security level, and custodial assignment for various categories of fixed assets. External Affairs has neither complete inventory records nor a custody grid to control fixed assets.

8.38 The Department's present fixed asset control systems do not comply with Treasury Board directives. The fixed asset inventories do not contain cost information, age or, for headquarters, complete information on the location of assets. Currently 12 or more headquarters divisions maintain separate inventory systems.

8.39 The Department had not considered opportunities for co-ordinating physical verification at headquarters to increase efficiency or opportunities for combining systems where appropriate. These systems cover telecommunications, EDP, security equipment, furniture and furnishings, vehicles and so on. Custody records in headquarters are not updated regularly. Internal audit has reported that many of the missions are not complying with the departmental materiel control procedures that require inventory lists for each chancery, official residence and staff quarter. Information cannot be easily combined at the macro level for establishing priorities when planning for fixed assets replacement.

8.40 The Department estimates its five-year replacement cost for furniture and equipment to be $160 million. The estimated value of its fixed assets is $220 million. The departmental information systems do not provide sufficient information to be able to validate these estimates. The departmental data base is not sufficient to identify losses, surpluses or obsolete items. This problem is caused by the lack of accurate records of holdings and lax procedures with regard to inventory inspections. In the absence of accurate systems, the Department can only estimate the value and condition of its materiel assets in order to forecast future requirements. Senior management cannot be sure that the current and requested levels of minor capital funding will enable the Department to meet its needs economically, efficiently and effectively.

8.41 **The Department of External Affairs should improve its fixed assets control records so that information needed for planning and budgeting for fixed assets is available.**

> ***Department's response:*** *The Department is in the process of improving its Headquarters' fixed asset records. Missions will be monitored for compliance with departmental instructions for inventory maintenance as contained in the Materiel Management Manual.*

Real Property

8.42 The Department of External Affairs is responsible for managing a substantial inventory of real property around the world. This includes 139 office buildings, 108 official residences, and 1,945 staff quarters. We found that the responsibilities for budgeting and monitoring overall departmental accommodation costs and for adherence to standards need to be consolidated, better defined and communicated within the Department.

8.43 The lack of clearly defined and communicated roles and responsibilities for real property management affects the economical and efficient management of those resources. The effects are:

- weaknesses in the accommodation planning process;
- ad hoc monitoring of departmental staff quarters accommodation costs and of adherence to staff quarter accommodation standards; and
- delays in issuing clear guidelines on property management to missions.

8.44 The Department's Bureau of Physical Resources has attempted to clarify its role. With the 1982 consolidation of federal government operations carried out in foreign countries, it became necessary for the various branches to establish their roles. Senior management did not approve the full role suggested for Physical Resources, on the grounds that the Bureau's role would need to complement the roles of the Geographic Branches, which had not yet been fully defined.

8.45 Moreover, the Department has left the Bureau's role unresolved while awaiting the government response to the recommendations of the Nielsen Task Force in 1985 concerning real property management in the federal government. The Bureau does have a clear role in property acquisition and development, functional guidance and assistance to missions. Its role is not clear in the areas of fiscal planning and budget review or in the review and monitoring of real property management by missions.

8.46 Currently, missions share with several bureaux in headquarters the responsibility for planning, funding and carrying out real property activities. Senior management through the Corporate Management Bureau sets budget allocations for geographic areas abroad and for other bureaux in headquarters. The spending of these budgets is then monitored by the area management advisers for missions and Corporate Management Bureau for headquarters. The responsibility for monitoring real property management and total accommodation costs for the Department has not been clearly assigned to any bureau.

8.47 Thus, it is not clear who has the overall responsibility for economic, efficient and effective management of property in External Affairs.

8.48 **The Department of External Affairs should clearly define and communicate roles and responsibilities for planning and monitoring accommodation.**

> ***Department's response:*** *Now that agreement has been reached outlining the respective functions of Public Works Canada and the Department for real property management, the roles and responsibilities of various departmental*

sections for planning and monitoring accommodation will be more clearly defined and promulgated.

8.49 In our 1982 audit we observed that the Post Property Manual issued in the early 1970s was out of date. During our follow-up review in the spring of 1985, we noted that a new manual had been drafted. This manual is still in draft form and has not been distributed outside the Bureau of Physical Resources.

8.50 The lack of clearly documented procedures for property management causes deficiencies in the information available to mission management. For example, there is little current information available to missions on what maintenance is to be provided by the occupant of residential property and what is considered normal maintenance to be paid for by the Department. There is also little information available to headquarters on the appropriateness of accommodations because missions are not required to prepare mission residential property plans that would indicate occupancy rates, market values, availability of other properties and so on.

Guidelines for Accommodation

8.51 The Department has developed, and Treasury Board has approved, standards for chanceries and official residences, whether leased or owned. However, the space guidelines proposed by the Department for staff quarters have not been approved by the Board. Leasing of staff quarters for up to $100,000 a year has been delegated to the Head of Mission. Consequently, the Department is leasing or acquiring staff quarters without any up-to-date guidelines on standards to be maintained for cost, size and location.

8.52 The space guidelines for staff quarters contained in the Treasury Board submission that has not yet been approved propose minimum and maximum ranges that are more generous than the previous standards (see Exhibit 8.3). The Department attempts to provide accommodation comparable to what a foreign service employee would have in Ottawa. However, there are no studies that provide a reliable base for determining the comparable level. This is further complicated by the fact that many Ottawa families have double incomes whereas employment opportunities for foreign service spouses are often limited.

8.53 In Canada, accommodation sizes are directly related to family income. Thus, to ensure comparability, the determination of an appropriate family income is important in establishing staff quarter sizes.

8.54 Even if the Department had good information on the Ottawa market, the comparative standard may not be relevant in many countries. Accommodation of the size and type found in Canada may not be available at a reasonable cost in some countries because of the conditions that exist there. Factors such as security, proximity to schools, building standards, climate, availability of accommodation and cost vary from mission to mission. These factors must be considered when applying global standards to a particular situation. Treasury Board's concern is that the maximum of the range would soon become the target if there were no effective monitoring by headquarters.

Exhibit 8.3

SPACE GUIDELINES
STAFF QUARTERS
(square feet)

Number Bedrooms	1968 Standards	Proposed Space: Minimum	Proposed Space: Target	Proposed Space: Maximum
2				
Non-program	956 - 1,054	1,161	1,333	1,505
Program	1,086 - 1,236	1,268	1,430	1,584
3				
Non-program	1,247 - 1,365	1,645	1,967	2,300
Program	1,741 - 1,935	1,870	2,139	2,408
4				
Non-program	1,408 - 1,559	2,042	2,386	2,730
Program	2,000 up	2,139	2,515	2,902

New single-detached houses financed under the National Housing Act in 1986 within the metropolitan area of Ottawa averaged 1,420 square feet.

8.55 The responsibility for monitoring the leasing of staff quarters is not clearly assigned to either the Geographic Branches or the Physical Resources Bureau. Senior management has expressed concern over the tendency of missions constantly to upgrade the size and quality of staff quarters. However, without appropriate benchmark data and comparative information, the monitoring function would be limited and could not be fully implemented.

8.56 The absence of approved guidelines hampers the acquisition and disposal process as well. Physical Resources is delaying a major purchase program for new staff quarters until the new guidelines are approved. The Bureau does not have firm size criteria for assessing mission requests to dispose of staff quarters that the mission deems to be inadequate.

8.57 The following case study illustrates some of the problems and costs resulting from the lack of approved guidelines.

Tokyo Staff Quarters

8.58 In 1980 the Department acquired two condominium apartments in Tokyo, for approximately $278,000 each, to be used as staff quarters. In 1985, the mission requested and received from headquarters permission to dispose of these non-program properties because, at 76 net square metres (817 square feet), they were smaller than other staff quarters. The mission stopped assigning these quarters to staff and the Department leased accommodation to replace them for approximately $123,000 a year. The mission did not dispose of the two condominiums but assigned temporary staff to them. The size of these properties is significantly above typical accommodation in Japan, where space can be obtained only at premium prices.

8.59 The Department of External Affairs should negotiate standards for staff quarters with the Treasury Board and monitor adherence to them by missions.

> ***Department's response:*** *The departmental submission on staff quarter standards was sent to Treasury Board on July 17, 1987. Once the submission is approved, an appropriate monitoring system will be established.*

Long Range Capital Program

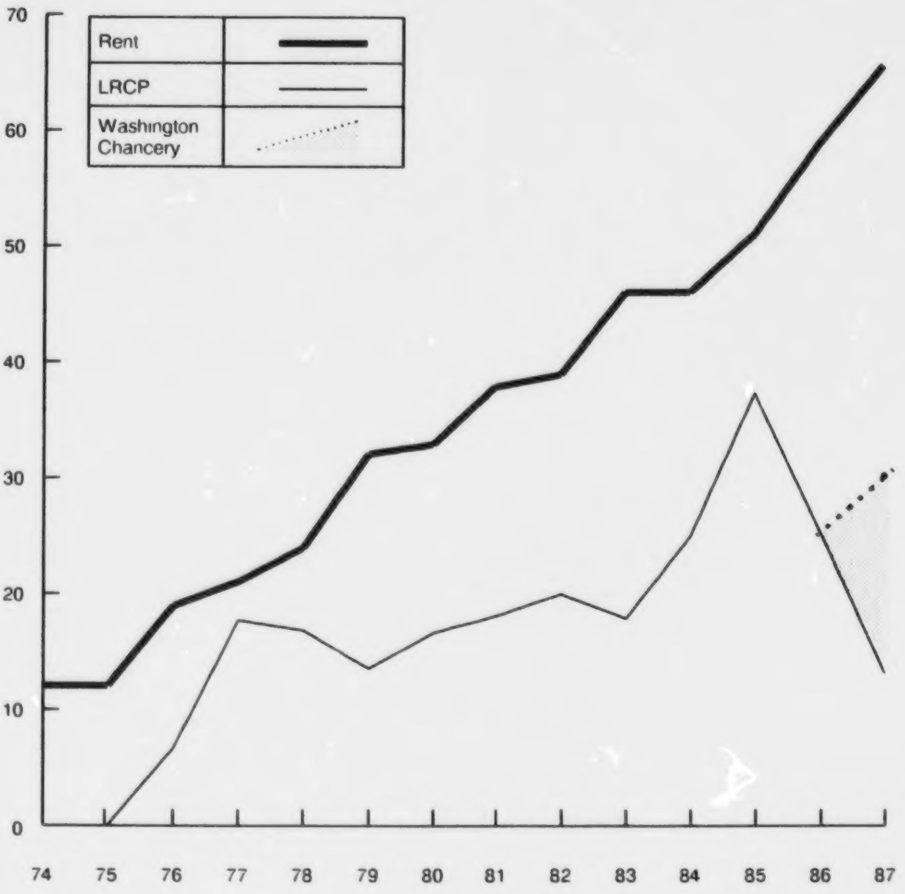
8.60 The main objective of the Long Range Capital Program is to increase Crown ownership of property. An intended benefit is reduced rental costs abroad. However, it is also designed to achieve other objectives related to security, fire safety, quality of accommodation, and the enhancement of Canada's image abroad. Meeting these objectives, while at the same time taking into account the demands created by other government policy decisions, new missions, increased program requirements and recreational needs, makes it difficult to achieve the desired savings in rental costs. The Department has had three five-year plans approved by the Treasury Board, in 1974, 1979 and 1984. In response to a request from the Board, the Department submitted a new plan in 1987.

8.61 There were several targets agreed on for the Long Range Capital Program. Progress toward those targets has been slow. The Department has aimed for 100 per cent ownership, where feasible, of chanceries and official residences and 70 per cent ownership of staff quarters. Currently, 29 per cent of chanceries, 68 per cent of official residences and 22 per cent of staff quarters are Crown-owned. Another target was a 55:45 ratio of design and construction projects to purchase projects. But during the past three years, 80 per cent or more of the budget has been spent on design and construction.

8.62 From the inception of the program to the end of 1986-87, approximately $250 million of an approved $321 million has been spent. This underspending has resulted from unforeseen delays in construction and purchases and government restraint programs. Furthermore, the Department has not been achieving the benefit of rental reductions to the extent hoped for. Exhibit 8.4 shows the rental curve from 1974-75 to 1986-87 compared to the Long Range Capital Program expenditure over the same period.

Exhibit 8.4

COMPARISION OF RENTAL COSTS WITH EXPENDITURES ON THE LONG RANGE CAPITAL PROGRAM
(in millions of current dollars)



8.63 The Department has made improvements to its capital planning process since our 1982 audit. It has established a Committee on Accommodation Priorities that reviews proposed projects and develops an overall priority rating for each. The committee subjectively assesses the requirements to arrive at the ratings.

8.64 This process would be improved if the information provided were better organized and included economic justifications. Ways to improve the information might include segregating projects to the extent possible according to needs, for example in areas of policy, program increase, safety, upgrading, rent reduction or replacement. Complete, comparative economic information such as anticipated implications for both capital and operating cash flows and the net present value of projects would assist decision makers. Some of this information is already available.

8.65 To develop information for setting priorities, the missions have to determine their needs and the options available to meet these needs in line with direction from headquarters. Many missions were not forecasting staff quarter needs beyond the immediate posting cycle. We found little direction from the geographic branches to assist missions in planning for their accommodation needs. No unit in headquarters had completed any macro-analysis on staff quarter costs such as per capita costs, percentage increases over time, size and so on, to determine whether needs were being met economically, efficiently and effectively. Such analysis would assist managers in setting priorities.

8.66 At the mission level, realistic input should be developed routinely and be readily available for consideration in developing the Long Range Capital Program. Although the old property manual and the current draft manual both call for preparing mission development plans, this is not being done. Physical Resources Bureau relies on telexes from missions and inspection visits to determine needs. These inputs are unstructured and difficult to use as input in formulating a plan. In addition, the plan may need to accommodate unforeseen events and priority changes. There must be communication with missions throughout the year concerning property plans.

8.67 In preparing its accommodation plans, the Department includes a number of back-up projects to be implemented only if funds become available because higher priority projects cannot be completed on schedule. However, these additional projects are not sufficiently developed to be put in place when projects are delayed or cancelled. Using a well developed contingency plan, the Department could make better use of the funds authorized for capital projects.

8.68 The Department of External Affairs should further improve its accommodation planning process by ensuring that inputs to the Long Range Capital Program result from a systematic review of current holdings, accommodation needs and costs.

> ***Department's response**: The Department agrees to improve Long Range Capital Planning procedures in the manner recommended.*

8.69 The Department of External Affairs should develop better contingency plan arrangements with the Treasury Board to ensure optimum use of the funds available for capital projects.

> ***Department's response**: The Department has submitted proposals to the Treasury Board under the Increased Ministerial Accountability and Authority (IMAA) process which, if approved, will give the Department the ability to more effectively manage its property portfolio.*

Meeting Program Needs Economically and Efficiently

8.70 The main determinants in the cost of accommodation are its size, location and age. The size of the accommodation is related to the standards mentioned previously, whereas location and age vary from mission to mission. In general the Department adheres to the Treasury Board approved guidelines for chanceries and official residences.

8.71 The proposed guidelines for staff quarters distinguish between where there is a requirement for official use and where there is not. In choosing accommodation, then, the mission should examine whether there is a program need and, if so, whether it could be satisfied by other means. We found that the missions were not addressing these questions. Although officers are required to keep diaries recording the use of residences for program purposes, analyses of these records are not done to determine if the level of activity justified the cost of maintaining quarters at the higher standard.

8.72 We noted that in major cities such as New York, London and Tokyo the Department either owned or rented very expensive accommodation in the centre of the city. Often this accommodation was occupied by persons with limited or no official duties or need for proximity to the chancery. Less expensive but equally comfortable accommodations were available in the suburbs. For example in New York, the 1986-87 rental costs for 54 staff quarters averaged $55,614. Non-program staff quarters in Manhattan cost as much as $79,900 a year. Similarly, staff quarter rentals in Tokyo averaged $97,271 in 1986-87. For the rented property, the Department could achieve significant rental savings by relocating some of these staff quarters.

8.73 A more difficult problem relates to Crown-owned property. The Department does not have the authority to apply disposal proceeds from offshore sales to new purchases. Thus, the Department does not actively assess whether properties could be disposed of to obtain more functional and less costly holdings. If a property is declared surplus and disposed of, there is no assurance that a replacement property will be purchased, since all acquisitions are subject to funding available in the Long Range Capital Program. Replacing an owned property with a rental puts additional strain on the mission rental budget and would be contrary to the Department's objective of increased Crown ownership of property. The effect is that the Department will sometimes hold onto a property that is no longer the most appropriate answer to its needs.

8.74 Another constraint on managing the Long Range Capital Program is the low authority level for contracts. The Department has a purchase and disposal approval ceiling of only $75,000. This means that the Department must obtain Treasury Board approval before it enters into any specific purchase agreements over $75,000. It cannot act quickly to purchase property, since few properties can be purchased for less than $75,000. This approval level was established some 10 years ago and has not kept pace with rising accommodation costs.

8.75 **The Department of External Affairs should review its operational needs and options with regard to accommodation for input to the planning process.**

> ***Department's response:*** *The Department agrees that operational needs and options are important in the planning process. The present process will be studied to identify areas where improvements can be made.*

8.76 **The Department of External Affairs should seek from Treasury Board a higher limit on its authority to acquire property, and authority to use disposal proceeds when acquiring property to be used for the same purpose.**

> ***Department's response:*** *Greater departmental authority limits are being requested under the IMAA and in the Department's submission on the Long Range Capital Program (1987-1992).*

Disposals

8.77 From March 1983 to March 1987, 35 property disposal transactions were under way or had been completed, with an estimated total value of $8,280,000.

8.78 In each of the cases we reviewed, there was an appropriate reason for disposing of the property, and estimates of its value had been properly obtained. The Department received the required approvals in all cases. We found, however, that the disposal process was slow because of delays in identifying and approving the disposal of properties that no longer met program requirements, and because of delays in selling.

8.79 Delays begin with the reluctance of missions to identify property as surplus unless it is clearly substandard, for the reasons noted previously. Headquarters does not monitor vacancy rates sufficiently to determine whether some properties are surplus to mission needs. The new computerized property information system contains the proper type of information to do this; it is in the final stages of implementation and will be an appropriate tool for management to conduct periodic reviews of vacant properties.

8.80 The next delay occurs at headquarters, where the Physical Resources Bureau must approve the surplus status of a property. This has taken anywhere from two months to two years.

8.81 Finally, delays occur in the selling process. In line with government practice, the Department normally uses public tenders to sell properties. This can have several effects including receiving a lower price or no acceptable offers. Active marketing of these properties through alternative processes could speed the disposal and might increase the amount received. In addition, the subsequent approvals by Treasury Board and Public Works Canada normally take six weeks; however, for normal foreign property disposals, the Public Works Canada review does not appear to serve any useful purpose. The Public Works review is intended to determine whether there are other federal government uses for the property. Furthermore, potential buyers view the time taken to receive approvals as inordinately long.

8.82 The following case study indicates the problems in disposing of properties.

Staff Quarters, Jakarta

8.83 A two-bedroom staff quarter in Jakarta had been vacant since at least 1980 before it was declared surplus in August 1983. The mission took several months to obtain appraisals, after which approvals from headquarters were almost immediate. When the mission called for tenders in July 1984, it encountered problems with local authorities and could not locate title documents, each adding to the delay. The mission obtained updated appraisals in September 1985. Four bids were received in February 1986 as a result of public tenders. Order in Council approval for the sale at $508,000 was received in June 1986.

8.84 The government should review its disposal procedures and the Department of External Affairs' disposal authority to minimize the delays in identifying and disposing of property no longer required.

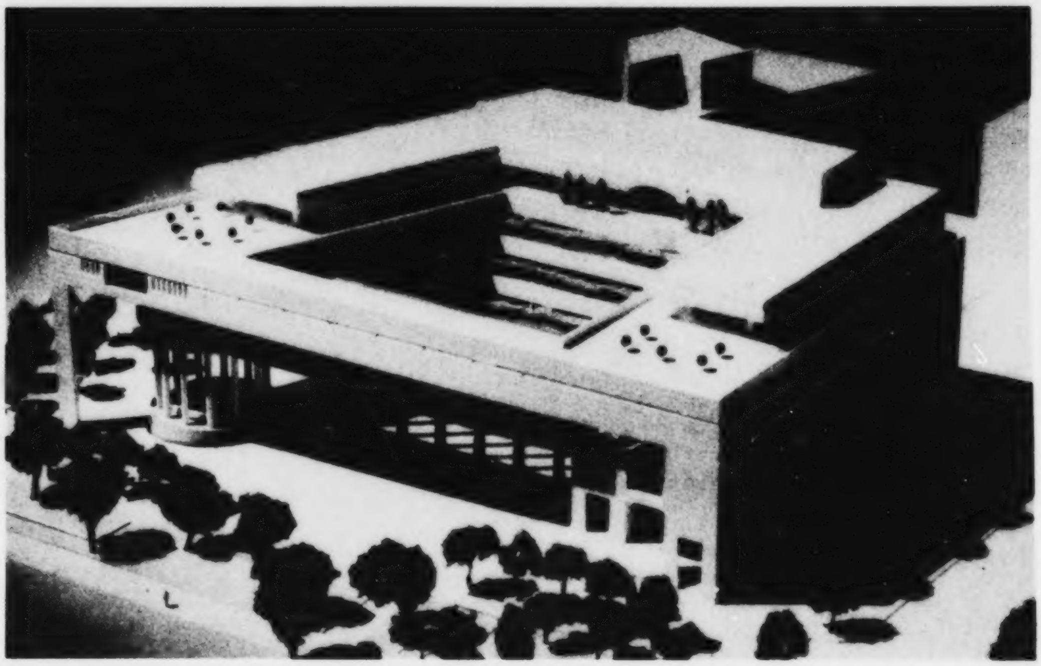
> ***Department's response**: The Department will co-operate fully in any review to increase its disposal authorities to minimize delays in identifying and disposing of surplus property.*

Project Management

8.85 The Department generally complies with the project management policies and guidelines established by the Treasury Board when acquiring new properties. The procedures used by the Department are adequate to ensure due regard for economy. However, the Department could improve the information prepared for project approval by always including the full life cycle costs. This would ensure that future years' operating costs were given adequate consideration before a decision was made to acquire a property.

8.86 **Washington chancery.** We examined the design and construction project for the new chancery in Washington, D.C.

8.87 From the beginning of the project, the Department proposed that the new chancery building would be of a style prestigious enough to project the desired Canadian image and presence in Washington, which the Department considers to be one of its most important locations abroad. The Department provided the Government with appropriate information on the desired location, style, size and cost of the proposed building, including those features peculiar to a chancery building. Based on this information, authority was given to the Department to proceed with design and construction.



Scale model of new Canadian Chancery in Washington, D.C. (see paragraph 8.86).

8.88 The choice of architect and architectural design were Government policy decisions made in 1982 and 1984 respectively. The building includes an auditorium, library and gallery designed to attract visitors. There are large open spaces to emphasize the openness of Canada. Our audit was limited to project management.

8.89 The Department is managing the project with due regard for economy in accordance with the various applicable authorities. We found that project management to date has been appropriate and that all project concerns have received due consideration. We noted that internal reporting structures are in place and are being followed, to ensure timely and accurate reporting of financial and project management information.

8.90 The Treasury Board gave project approval for $81.7 million. Of this amount, $54 million is for the construction of the building. Construction is under way and the building is expected to be complete in the spring of 1988. Current projections show the project being completed slightly under budget.

8.91 One cost-related issue is that the Department, in making monthly progress payments, does not take full advantage of the 40-day period allowed for payment as stipulated in the contract. The Department claims to be making these payments to expedite construction. We estimate that the opportunity cost of the early payments could be $120,000 by the time the project is complete.

Human Resource Management

8.92 The audit of human resource management covered three areas: human resource planning, the foreign service directives, and leave. In previous departmental audits we examined human resource planning. We observed significant improvement since then, although there are still areas that could be improved.

Human Resource Planning

8.93 The Personnel Branch has recently linked the human resource planning process to the departmental planning process. The Corporate Management Bureau co-ordinates production of information by location on the number of person-years required. Personnel Branch develops a long-range human resource strategy and a multi-year human resource plan that is linked to the Corporate Management Bureau person-year allocations. The strategy notes the challenges facing the Department as a result of restraint and new technology. It also highlights the need for extensive training.

8.94 As we noted in 1986 for the Trade Function, the main deficiency in planning is the lack of skills identification. In response to our 1986 observations, the Department promised to formally document employee function skills and enter them in an existing data bank. A functional skills inventory is needed with regard to all employees. The Branch plans formally to register employee functional skills information, but the implementation of these plans is dependent on the purchase of a new computer.

Training

8.95 Personnel Branch develops a training plan and budget based on the training requirements identified by management and individuals. The Department has an appropriate process to identify training needs. Immediate supervisors identify the training requirements of the work place and of individuals they supervise; the Training Division then develops appropriate training plans. With consideration given to departmental priorities, the various training plans are then consolidated to form a program for management approval. However, we noted that some of the key training was not considered mandatory.

8.96 We found that the Department had appropriately qualified individuals assigned to training. However, the Training Division does not monitor and evaluate its courses systematically and comprehensively. As a result the Department does not know if it is achieving its training objectives.

8.97 Our prior audits as well as internal audits have noted that the training of individuals with financial responsibilities at missions was weak. The Finance Bureau and the Training Division developed and delivered (in Dallas and Caracas) a two-week course for locally engaged accountants. The studies also noted that to carry out their duties effectively, Canada based financial officers required training of the kind contained in a course delivered in June 1986. This course was developed for clerks and administrative officers who would be taking on financial management duties at missions with their next assignments. However, the 1987 course was cancelled due to an insufficient number of available trainees. Some ad hoc training will be given by the Finance Bureau for those posted from headquarters in 1987. There are no assurances that people being assigned to finance positions will have had appropriate training prior to assuming their new positions. Such training is important since at most missions there is no one to give these employees technical supervision and they must be capable of working largely on their own.

8.98 The Department of External Affairs should introduce monitoring and evaluation procedures to determine whether training is meeting its objectives.

> ***Department's response****: The Department of External Affairs fully accepts the importance of monitoring and evaluating its training programs. In a first phase, the Training and Development Division will evaluate and validate the five day Consular Training Program using the Systems Approach to Training. Further monitoring and evaluation procedures will be introduced as required.*

8.99 The Department of External Affairs should ensure that employees receive needed training prior to posting.

> ***Department's response****: The Department of External Affairs makes every effort to ensure that employees receive needed training prior to posting and offers numerous courses in this regard. The 1987 Financial Course was cancelled because most of those who would normally be considered for such training had taken the same course in June 1986 or had acted as Assistant Area Management Advisers in the past where they had obtained the equivalent training. Individualized training is being offered to the few (3) who require it to ensure that they have the necessary knowledge/skills to perform their duties.*

Foreign Service Directives

8.100 The life of the public servant in the career foreign service has often been perceived as glamorous. Although there are some specific attractions, the reality is somewhat less rosy. Some of the missions pose definite hardships for the foreign service employee. There are security problems, cultural differences, language difficulties and unfamiliar climates. These hardships extend to the employee's family as well. Spouses are often unable to work and children are regularly being moved to new educational and social environments. The government has responded to this situation through the foreign service directives.

8.101 The foreign service directives constitute a large (450 pages) complex document. They cover diverse areas such as benefits, housing and travel. The directives are based on comparability with living conditions in Canada, and are intended to provide incentives to persuade people to go to undesirable locations, and program related incentives. We examined all the directives in general and three in depth. The directives we examined in depth required input from both the employees and the Department to administer.

8.102 The directives are clear in their overall objectives:

> the foreign service directives are designed to provide a system of emoluments and condition of employment that, in combination with salary, will enable departments and agencies to recruit, retain and deploy qualified employees to devise, execute and support effectively and economically the various departmental programs outside Canada...

8.103 **Triennial review.** The foreign service directives are reviewed every three years and changes are proposed both by management and the employee staff associations. In effect this has become a labour-management bargaining session. Management is in the process of developing a model for costing the directives and identifying the impact of changes to them. As well, an interdepartmental working group was established to review the directives and determine if there were alternative ways of achieving the desired result. Although there are some informal indicators, there is no formal procedure for determining the extent to which the directives are achieving their stated intent.

8.104 We reviewed the process followed for the last triennial review in 1985. The Department had prepared a list of proposed changes and reviewed it with the Treasury Board Secretariat. The Secretariat costed the various proposals and sought a negotiating mandate from the Treasury Board. The Treasury Board Secretariat representative leads the management team in the negotiations.

8.105 We found that the Department did not have an estimate of the cost of approved changes to the directives that could be used to monitor actual expenditures and prepare budget estimates. Such costs could also be used to assess whether the amendments were being applied according to the intent of the directive.

8.106 **The Department of External Affairs should compare actual costs to estimated costs of changes to the foreign service directives and determine reasons for variances.**

> ***Department's response:*** *The Department has monitored the cost of changes to the foreign service directives informally and agrees that there is a need to establish a more formal monitoring process. We can agree, in cooperation with the Treasury Board, to establish an estimate of costs resulting from negotiated changes to the directives and to take this into account in existing budgetary procedures relating to the foreign service directives.*

8.107 **The Treasury Board Secretariat should regularly evaluate and report the extent to which the foreign service directives achieve their intent.**

> ***Treasury Board Secretariat response:*** *The Treasury Board Secretariat, in conjunction with those departments employing staff on foreign assignments, has evaluated the applicability of the foreign service directives prior to each triennial review of the foreign service directives. This working group recommends those changes, additions and deletions that are deemed necessary to enhance the*

efficiency/effectiveness of the individual directives. During fiscal year 1986/87 this review process was augmented by a fundamental review of the directives that examined the possibility for more fundamental change and simplification of their administration.

In future the foreign service directives will also be reviewed and reported on regularly by the Planning, Evaluation and Policy Development Division of the Treasury Board Secretariat during their cyclical review of all Treasury Board Personnel Policy Branch policies. The initial review of the foreign service directives under this program is scheduled for fiscal year 1988/89.

8.108 **Clarity of intent.** Although the overall objectives of the foreign service directives are clear, the intent of some individual directives is not. An example of lack of clarity is the Foreign Service Travel Assistance Directive which states:

> it is in the interest of both management and the employee that an employee has the opportunity to visit Canada during and/or at the end of each posting.

The directive then goes on to say:

> certain travelling expenses ... may be paid to assist them in taking vacation leave in Canada or, at the employee's request, some other location, within a prescribed cost limitation.

8.109 There are no criteria as to when management should agree to an employees request for an alternative location. If an employee always requests an alternative location, then the objective of visiting Canada is not met.

8.110 In the case of the Foreign Service Leave Option Directive, which offers the employees the option of converting foreign service leave to cash or airline tickets, the amount of leave that has accumulated is creating an increasing liability for the Crown. This directive contains no reference to its intent. At the beginning of 1986-87 the balance of foreign service leave was 70,201 days. In January 1987 the balance stood at 73,129 days, which has an approximate value of $12 million. Approximately 25 per cent of the 1986-87 earned days had not been used.

8.111 **Complexity of the directives.** The Department recognizes that the directives are very complex. It is working with the Treasury Board to find alternative ways of providing the benefits and achieving the results. Although this may reduce the number of directives, it is not aimed at reducing the complex wording and interrelationships that exist among them. The directives would be easier to use if there were an index or if they were computerized. This would enable an officer to locate relevant cross-references to assist in interpreting the directives. Computerization would also help in analysing the impact of changes to the directives and identifying further changes required to ensure consistency. Because of the complexity of the directives and the resulting room for different interpretations, the Department has conferred unintended benefits on the employees such as travel expenses to pick up vehicles when posted.

8.112 The Department of External Affairs should examine ways to simplify the foreign service directives and make them easier to apply.

> **Department's response**: *During the period September 1986 to June 1987, an extensive review was undertaken by an interdepartmental working group and a steering committee of ways to simplify the foreign service directives. A number of proposals have emerged and have been incorporated into the official side mandate for the triennial review consultations with staff associations.*

8.113 Compliance. We selected at random a sample of employees and examined their use of three foreign service directives for compliance. We found errors on many of these files that were attributable to employees at missions who sign under the authority of section 27 in the Financial Administration Act, Personnel Branch or Finance and Headquarters Administrative Services Bureau. In all instances the employee was entitled to some benefits under the directive being used. However, we concluded that there was extensive non-compliance with the directives. In some cases this resulted in unintended benefits to employees at an increased cost to the Crown. Because of the diversity of the directives, it was difficult to quantify the effect of non-compliance.

8.114 Foreign Service Relocation. This directive provides the authority for paying relocation expenses to employees when the government posts them abroad or brings them back to Canada. In 1986-87, $20.7 million was paid out under this directive. Of the 56 files we reviewed, 20 had problems of interpretation and compliance. For example, the directive states that an employee is entitled to two days in temporary accommodation unless a longer stay is authorized in advance. We noted 12 instances where this two-day limit was exceeded without any evidence of authorization. In one case, the employee and family were in temporary accommodation for 41 days at a cost of $30,700. Minimizing temporary accommodation is one way the Department could operate more economically.

8.115 This directive is also unclear on the matter of shipping private motor vehicles. This has resulted in reimbursement to employees for expenses that are not allowed under the directive. The Department has clarified its interpretations through internal memos. However, if the directive itself is not clarified, this situation could recur in the future.

8.116 Foreign Service Leave Option. This provides for the accumulation of foreign service leave at mission. Benefits of $2.3 million were paid in 1986-87. The leave credits can be used as leave, traded for airline tickets, or converted to cash. Of the 18 files we reviewed, 15 had problems with compliance. The most significant problem was that the leave taken was not properly reported because of non-compliance with departmental procedures. A second problem was that the employees were not providing necessary documentation (quotes from travel agents and ticket stubs). Thus the Department did not always have adequate records to validate the use of this directive. The Department has recently taken steps to rectify the situation.

8.117 Foreign Service Travel Assistance. This directive is used primarily to give the employee air fare assistance when taking leave outside the host country. The provision cost $4.4 million in 1986-87. In our sample of 30 cases, 17 did not fully comply with the provisions of the directive. We found that documentation concerning the application of the directive is not always reaching the individuals responsible for administering it. This results in the provisions of the directive not being appropriately followed.

8.118 The Department of External Affairs should improve its procedures for monitoring compliance with the foreign service directives to ensure that employees are meeting the conditions set out in them.

> ***Department's response:*** *We agree that a continuing effort to improve procedures for monitoring compliance is required and we note the Office of the Auditor General's comment that in the case of the shipment of private motor vehicles, the interpretation has been clarified. The Office of the Auditor General is also aware that guidelines were revised recently with a view to minimizing time in temporary accommodation.*
>
> *Our ability to monitor compliance depends to a great extent on the post administration. We believe that by making a recently improved and expanded course on the foreign service directives for office managers mandatory, the problem of lack of compliance will be significantly reduced.*

Leave

8.119 The use of foreign service directives provides an audit trail that can be followed to ensure leave is properly recorded. For example, the travel assistance directive requires that an employee take 10 compensatory days leave to receive the benefit of the directive. In the files we examined, we found an error rate of 30 per cent. Over 90 per cent of the errors resulted in employee leave credits higher than they should be. This raises an overall concern about the validity of the leave records for the Department as a whole.

8.120 Prior to 1984 the leave records of External Affairs were not centralized, but were maintained at individual missions. Not all missions responded promptly to the call for centralization. Consequently the centralized records are not complete. In addition, the leave records sent to headquarters are often inadequate. Personnel Branch is verifying its records by asking employees to confirm the correctness of their leave records.

8.121 When taking leave, an employee is required to submit a leave request form. This is not always done. The immediate supervisor approves the leave; however, the number of errors we noted led us to question the rigour of the supervisor's review. In the current process, an employee's failure to submit a leave form could go undetected.

8.122 The following telex of 1 April 1987 illustrates some weaknesses of the leave system:

> "since arrival"..."aug 86, subj has not/not received new leave print out and therefore has no/no up to date info re remaining annual leave for 1986/87 (thought to be about two days). Info needed for carry over application, which is now requirement for his cat(egory). Grateful if you could provide this info by tel, taking

> into account leave taken in 1986 between posts. Unfortunately records up to time of cross posting not not available at either post so he is unable to recalculate"

8.123 **The Department of External Affairs should strengthen its procedures for recording and monitoring leave.**

> ***Department's response**: The Department of External Affairs fully understands and accepts the importance of having in place an efficient system to ensure that all leave taken is recorded. The problem identified in the report is attributable at least in part to the fact that leave records are maintained at posts as well as at headquarters and procedures for recording leave taken on transfer between posts and headquarters have been inadequate. The Department is at present undertaking an extensive review of procedures for recording and monitoring leave to identify the modifications necessary to bring current procedures up to acceptable standards.*

Internal Audit and Program Evaluation

8.124 External Affairs has organizational units in place with clear roles and responsibilities for Internal Audit and Program Evaluation. The mandates for these divisions conform to the guidelines provided by the Office of the Comptroller General. The Audit and Evaluation Committee oversees the operations of the Internal Audit Division and the Program Evaluation Division. The Committee is responsible for following up on the implementation of corrective measures addressing major issues.

Internal Audit

8.125 The responsibilities of the Internal Audit Division are comprehensive in scope. The Division has prepared a long-term audit plan, which was reviewed and approved by the Audit and Evaluation Committee and which provides for auditing all the Department's responsibility centres. However, major slippages have occurred in the schedule. For example, 20 audits of the administrative program at missions were completed in 1985-86 out of 35 planned; 17 of 34 planned mission audits were completed in 1986-87.

8.126 The Department's policy on internal audit requires that the Division participate in major systems development to ensure appropriate internal controls are installed. However, the Internal Audit Division did not participate in the development of the new financial information system or the new communications system.

8.127 The Division realizes that it has not fulfilled its mandate and has attributed this to a lack of resources. However, alternatives such as focusing its attention on the high priority issues or reducing the scope of some of its activities have not been explored.

8.128 We found that the completed audits provided sufficient evidence to support the observations made. The Division issues its reports promptly. These reports are adequately supported by the audit files, but they could be improved by focusing more on the main audit issues and eliminating some detailed information that is time consuming and costly to produce. This would facilitate management review and subsequent follow-up.

Program Evaluation

8.129 As we reported in 1986, the Program Evaluation Division is devoting a large part of its efforts to resource base reviews. These are useful exercises that help management address the concerns of operating in a climate of constraint and help to identify and eliminate distortions that may result from changes in the environment. As well the resource review creates a data base that can be used in future evaluations and offsets the incremental nature of the planning process. However, all this has meant relative inactivity in measuring program effectiveness.

8.130 The Division has completed evaluations of some of the activities of the Trade function. However, it has not completed evaluations of the full range of activities of any of the functions listed in Part III of the Estimates. Its evaluations have tended to focus on lower level issues, or parts of programs. Evaluations completed over the last two years include:

- Import/Export Controls
- WIN Exports computer system
- Health Care Abroad: Mini-clinic Pilot project
- DEA Foreign Language Training Program
- Interdepartmental Review of International Exchange Programs

8.131 Three evaluations were in progress and four were planned. The focus of these evaluations continues to be the Trade function.

Telecommunications and Records Management

8.132 The telecommunications system is the Department's central nervous system. It is the medium through which missions communicate to headquarters and among themselves. It is important to note that in managing this system, the Telecommunications Division is responsible only for the means of communication, not the content. In this regard the Division forms a partnership with management to ensure that operational needs are met.

8.133 The Department recently began the implementation of an enhanced secure information management system that will extend the computerized communications system to the desk top, incorporating office automation and on-line records management. The goal is to move toward a paperless office. In its Treasury Board submission the Department estimated the cost of the new system at $111 million over a seven-year implementation period. Once it is fully implemented the Department expects to save $16.2 million per year.

8.134 The Department plans to implement the Canadian On-line Secure Information and Communications System (COSICS) in two phases and by geographic area. The first phase includes the missions in the United States and some parts of headquarters at an estimated cost of $28.8 million. A full evaluation of results and impacts on operations is to take place before the second phase. After each installation is complete, an operational evaluation will be conducted.

8.135 The introduction of the new system will have a major impact on employees. It also has the potential to improve the Department's outputs in that information will be created, exchanged, stored, retrieved and placed in archives in a new way.

8.136 In reviewing this system we noted that it is a very progressive step for the Department. When successfully implemented, this system will be among the most sophisticated secure information management systems in the world and will move the Department to the forefront of technology in the foreign service community.

8.137 In discussion with the system managers, we learned that the Department does not intend to develop the system itself. Although it has a concept, it does not have the technical resources available to design and develop a major system like this. Therefore, consistent with the Treasury Board Information Management Policy, the Department decided to challenge the expertise available in the private sector to design, develop and install the system using equipment available in the marketplace on the basis of a detailed request for proposals.

8.138 Our opinion is that to make the system work it must be designed to meet the needs of users. To achieve cost effectiveness, the Department recognizes that user needs have to be defined in as detailed a way as possible before the system is designed. The designers need to know what users expect the system to do, how they will use it and the level of service expected of the system.

8.139 The needs of the users have been identified by the Department. A users' committee was formed in August 1986 to provide input to the project team concerning user needs. One of the objectives of phase I is to refine and, to the extent possible, confirm user needs. This work is designed to take into account the new and different demands users will put on the new system. As COSICS is implemented, the network administration will monitor traffic levels to ensure that all installations have appropriate capacity.

8.140 In its request for proposal, the Department asked suppliers to bid on the basis of capacity processing for a specified number of terminals at each site. This document states that the site requirements may change at the time of installation due to circumstances unknown to the project team. Consequently, the price for specific units may be fixed, but the overall project cost at any specific site is open and may be subject to negotiation with the supplier.

8.141 To develop the costs of the system for the Treasury Board submission, the Department made a number of assumptions and notional estimates. External Affairs sees phase I as an opportunity to test and further validate these assumptions and estimates.

8.142 Because the submission contains several assumptions that the Department intends to test in phase I, and because the specifications have not been set, the cost estimates and savings cannot be accurately predicted by the Department at this time.

8.143 **System evaluation.** The Department's plan to evaluate before the second phase is appropriate. The Treasury Board Secretariat has indicated that future funding is dependent on the results of the evaluation.

8.144 **Conclusion.** The Department has been forward thinking in proposing this enhanced secure information management system. It is our opinion that time expended in planning is well worth the benefits derived later in implementation. However, the Department has adopted an approach where specifications and costs are not fully defined until implementation is well under way. We believe this creates a high risk that cost estimates will be exceeded and predicted savings will not be realized. Evidence of the Department's innovative approach and concern for this project is its drawing it to our attention prior to major expenditures. We plan to audit this project at appropriate intervals throughout its life.

Records Management

8.145 The Internal Audit Division completed an audit of the records management function in External Affairs. We followed up on that audit, relying on the work done. Management has taken significant action to correct many of the deficiencies noted in the audit. However, a major problem persists: the users of the system are maintaining their own records and not making use of the central records.

8.146 This is serious since the central records cannot be up to date if the officers do not return material for filing. Moreover, several important branches do not have their files incorporated in the central records system. Potential users of the system do not have confidence that the system will generate the needed information. The processes adopted by the Department to provide a central record are expensive, and the current level of usage raises a question whether it justifies the resources allocated to it.

8.147 The Records Information Management Division has started an awareness campaign to encourage officers to use the information storage and retrieval system. However, plans to convert files not in the central records system to central records have been stalled by resource constraints.

8.148 Internal Audit pointed to a low quality of input and productivity (5 to 15 documents indexed per day per officer) that has yet to be corrected. There continue to be extensive backlogs of material to be classified and indexed.

8.149 In response to the internal audit, the Division developed a set of monthly statistics that quantifies its workload. This information has not been analysed to show the productivity attained. Division managers stated that the productivity is made up of several components that need to be reviewed together. The Division has not established productivity standards for the components of the workload. Such standards are needed to analyse current performance and develop plans to improve productivity.

8.150 The Department of External Affairs should develop productivity measures and standards for records management with a view to improving productivity.

> ***Department's response**: The Department agrees that productivity measures need further development. It is the intention of the Department to use the recent Advisory Council Report on Records as a basis for establishing productivity measures in the traditional records management area. In the automated records management area the Department has a fairly mature data base and is in the process of reviewing this material with a view to applying the results against performance measurement and productivity improvement.*

DEPARTMENT OF NATIONAL DEFENCE
MAJOR CAPITAL PROJECTS

DEPARTMENT OF NATIONAL DEFENCE
MAJOR CAPITAL PROJECTS

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Exhibit

9.1 Equipment Life Cycle Stages Reviewed

9

DEPARTMENT OF NATIONAL DEFENCE MAJOR CAPITAL PROJECTS

Introduction

9.1 The Canadian Forces' requirements for equipment, people, facilities and systems are determined by the roles, objectives, and operational tasks that have been identified to meet the broad objective: "to ensure the security of Canada and to contribute to the maintenance of world peace". The detailed requirement for equipment items is determined as part of the overall force structure planning processes that occur for both the regular and reserve forces.

9.2 Since the late '70s, the Department of National Defence has spent billions of dollars on very large capital projects intended to upgrade or replace its deteriorating hardware. Billions more have been committed for future expenditures for these purposes. By the late 1970s most Defence equipment, such as fighter aircraft, ships and vehicles, was either at the end of its expected useful life or rapidly approaching it. By that time, expenditures on capital items had reached a low of eight per cent of DND's budget because of pressures to downsize the forces and cut back on expenditures. The Defence Structure Review, carried out in 1975, outlined in part a "re-equipment plan" that would attempt to reverse a critical situation that was contributing to a rapidly declining military capability.

9.3 As mentioned in the report on our 1984 comprehensive audit of National Defence, projects of this magnitude place a significant strain on management and personnel systems. They involve a wide range of private sector, inter-departmental and departmental interests that concern such diverse areas as regional and industrial benefits, technological considerations and social factors.

9.4 Notwithstanding all these difficulties, the projects must be delivered on time and within budget. The newer and more complex technology used now in equipment creates a greater demand for experienced project managers and life cycle support staff. It also demands rigorous and regular testing against operational requirements to ensure that the product meets the extreme demands of combat conditions.

9.5 The correct selection, use and care of equipment are essential to meeting operational commitments. The Department has established a comprehensive set of management systems for this purpose, and they are employed over the life cycle of all projects. Once identified, an operational deficiency, need or opportunity becomes part of the equipment program. After lengthy analysis and comparison to other proposals, it enters the Defence Services Program as a project and is processed through the various approval stages and decision points of the Defence Program Management System, until it is given departmental approval. For major capital projects (valued at more than $10 million), Treasury Board approval is required. For major Crown projects (those valued at more than $100 million), Cabinet approval is required.

9.6 Because of the enormous financial significance and impact of major capital projects, both within departments and on Canada's socio-economic well-being, this Office announced in 1985 that it would undertake to review and report to Parliament whether departments were exercising due regard to economy in managing them.

9.7 Our approach in the case of National Defence, which has about 80 per cent of the government funds devoted to major Crown projects, was to examine the management systems and practices that govern these types of expenditures, and to test individual projects' compliance with the controls established in the systems.

9.8 As part of our first comprehensive audit of National Defence in 1982, we reviewed several major management systems, including the Defence Program Management System, that the Department uses to screen equipment project requests for funding before submitting requests to Treasury Board. We concluded that the Defence Program Management System was fundamentally sound and that it included appropriate checks and balances.

9.9 In 1984, as part of our second comprehensive audit, we focused more on case studies of equipment acquisition to test some specific elements of the total DND project management system. We reported on seven major Crown projects and made a number of observations and recommendations. In its meetings on the Defence chapter in February 1985, the Public Accounts Committee expressed its interest in continuing the approach of reviewing large Defence acquisitions individually.

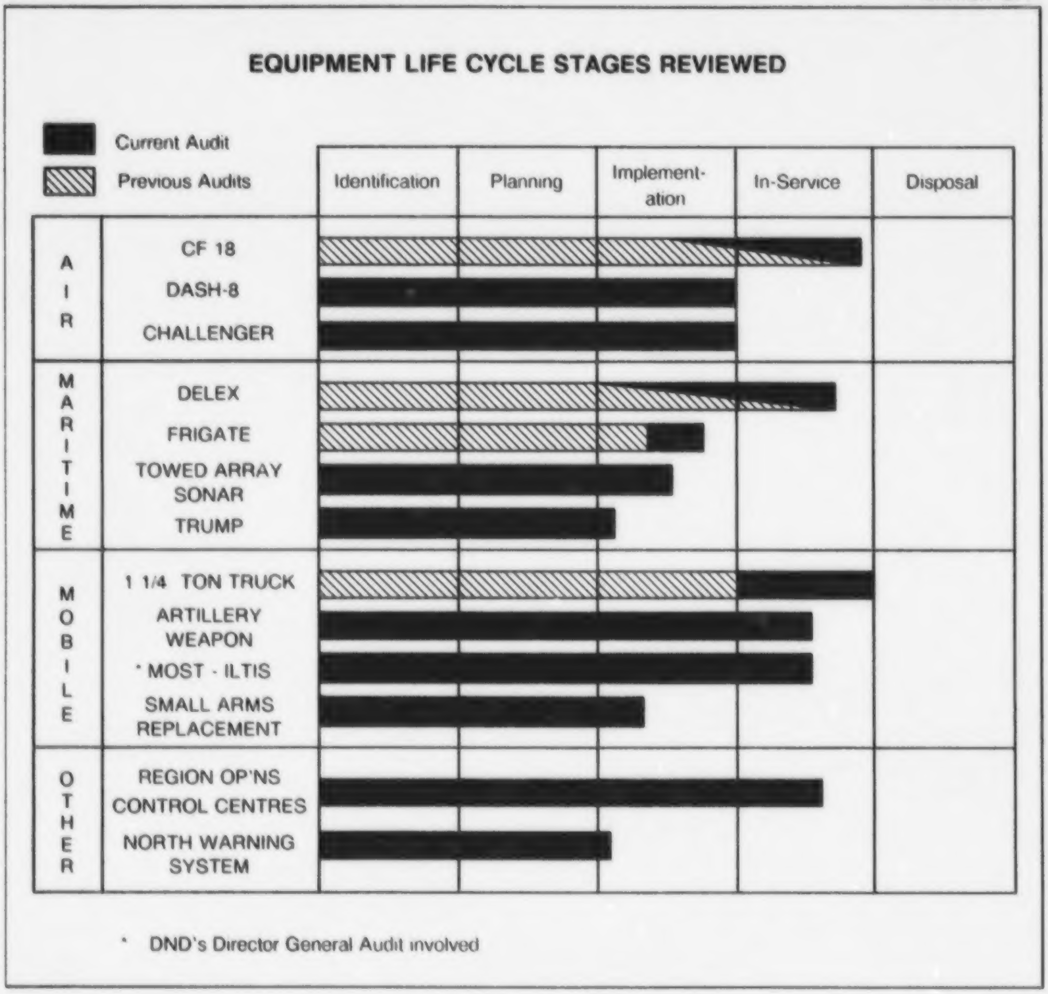
9.10 The objective of this year's audit was to examine other aspects of the total project management system by reviewing a selection of major capital and major Crown projects through the Identification, Planning, Implementation and In-service stages of their life cycles. Elements of the system that were reviewed in the past were re-examined to assess progress in response to earlier recommendations and to re-test compliance with system requirements.

9.11 As part of our examination we paid particular attention to contracting activities; this resulted in our making some new observations that cross individual projects. These are highlighted later in the chapter. More detailed background information, conclusions and observations related to the projects audited are reported at the end of the chapter in individual project summaries.

Audit Scope

9.12 We examined 10 major Crown projects each costing more than $100 million, and 3 others costing between $60 million and $100 million. We continued the approach used in 1984 of testing management systems and practices in National Defence by examining the projects through their life cycle stages. In addition, we followed up on broad issues that were identified during earlier audits. Exhibit 9.1 shows the life cycle stages examined for each project for this audit and for our 1984 comprehensive audit.

Exhibit 9.1



EQUIPMENT LIFE CYCLE STAGES REVIEWED

* DND's Director General Audit involved

9.13 We reported in 1984 that departmental internal audit had not carried out any major Crown project audits, and we encouraged the Department to review these projects. Since then the Department has developed methodology and plans are in place to audit several major Crown projects. For the purposes of this audit, we relied on the work of the Department's internal audit group for the one project completed to date – the 1/4 Ton Iltis truck project. We carried out audit reliance tests to confirm compatibility of departmental audit approaches with our own.

9.14 We had originally planned to audit the Low Level Air Defence project, but have deferred it to avoid possible conflict with an investigation into the circumstances surrounding the purchase of land for the construction of a Canadian facility by the prime contractor.

9.15 Our audit of capital projects involved an examination of documents, interviews with officials in the Department of National Defence, the Department of Supply and Services and the Department of Regional Industrial Expansion, visits to several prime contractor facilities, observation of equipment under construction, and a review of project files and reports. We did not audit contractor records or facilities.

9.16 We also examined a sample of smaller capital projects in the $5 million to $60 million range for compliance with governing procedures and regulations. Projects of this size have not been the subject of our previous audits of the Department of National Defence.

Observations and Recommendations

9.17 The Treasury Board has issued directives and policies that Departments are expected to follow in the management of Government projects. DND has elaborated on these policies and directives with an extensive set of management systems and practices that it uses to manage projects through their full life cycle.

> Our audit indicates that the management systems and procedures used by DND for major capital and major Crown projects are appropriate, and that projects are usually managed in compliance with the requirements of these systems and procedures.

9.18 DND's management systems and procedures related to major capital and major Crown projects are being steadily improved. By 1970, the Department's equipment acquisition budget had declined to a low of eight per cent of total expenditures; however, the increased activity of the last decade and the many very large projects that have been funded have placed extensive demands on management and on management systems. Each new project brought with it a new set of challenges, with lessons learned for later projects.

9.19 In previous audits we commented on the difficulties DND has encountered in planning and managing some projects, and we made a number of recommendations. As well, the Public Accounts Committee has put forward other recommendations. DND has made several changes to systems to address the concerns behind the recommendations. These initiatives are discussed in more detail in the next section dealing with follow-up.

9.20 As a result of this audit, we have suggested five areas where we believe additional management attention should be given. Two of these items – non-military objectives and project scope and cost – are extensions of points we raised in 1984. Three items, dealing with sole-sourcing, advance payments and warranties, result from the reviews of contracting arrangements that we included in this audit. These points are discussed starting at paragraph 9.49.

9.21 Our audit of smaller capital projects did not reveal any significant concerns where we believed additional management attention was required regarding further improvements to systems and procedures.

Follow-up

9.22 Of the 29 recommendations contained in our 1984 Report, five dealt directly with capital project planning and management. One other recommendation dealt with the need for a force structure plan, which affects the planning and management of all DND's resources. Seven of the eight recommendations made by the Public Accounts Committee focused on aspects of planning and managing of capital projects.

9.23 Our review indicates that DND has responded positively to these recommendations.

9.24 **Project scope and cost.** In our 1984 Report, we noted that projects managed by the Department are often bound by fixed funding ceilings. But in many cases they involve a high level of technological complexity and uncertainty because weapons systems are often still being designed and tested during the acquisition process. In the case of the CF-18, we reported in 1984 that this resulted in the identification of a large number of related highly desirable projects budgeted outside of the main project. To help address this dilemma, we put forward three recommendations: uncertainties in the concept of operation should be minimized before a project begins; alternatives to fixed ceiling funding should be considered for equipment that is still in the development stage; and DND should ensure that all significant scope or cost changes are reported to Treasury Board. The Public Accounts Committee then made three related recommendations that dealt with the definition and disclosure of project life cycle costs.

9.25 DND has responded to these recommendations to the extent it can, given the size and complexity of these projects. The Department acknowledges the need for clarity in concepts of operation. To the extent possible it achieves this in the Statement of Requirement that is part of the approval process. Although funding ceilings may be a preferred management discipline, improvements in project costing and in the reporting of scope or cost changes to Treasury Board should ensure that difficulties which may result from fixed ceiling funding can be overcome. The Department is developing and testing approaches to define life cycle costs fully for major Crown projects, and has included project life cycle cost estimates in Part III of the Estimates.

9.26 **Non-military objectives.** In 1984, we noted that non-military objectives, including industrial benefits, complicate and constrain DND equipment projects. Non-military considerations have resulted in projects being split among potential suppliers to distribute the economic benefits; directing contracts to suppliers; additional costs to establish Canadian capabilities; and implementation difficulties with newly designed Canadian models. We recommended that contracts should clearly specify industrial benefits requirements, and the Public Accounts Committee recommended that non-military objectives be identified in the Estimates, Part III, and that their attainment be monitored and reported.

9.27 Implementation of all these recommendations is complete, and non-military objectives are reported in the Part III of the Estimates. But the cost of achieving these non-military objectives is not. This aspect is discussed later.

9.28 **Project management.** We noted in 1984 that DND did not have one basic management system that was common to all projects and different systems were implemented for every project. We reported the Department would benefit by establishing a common system that could be tailored to meet individual project needs.

9.29 By mid-1985, the Department had identified 45 areas for development and had published 17 papers dealing with this recommendation. In January 1987, DND reported that the management system was evolving satisfactorily, and that various mechanisms, including a Project Management Support Office, a Project Management Handbook, and a requirements definition for a Project Management ADP System, had been incorporated into the Department's operations.

9.30 **Sources of spare parts.** The Public Accounts Committee noted that savings were possible through diversification of equipment suppliers and direct purchases from original equipment manufacturers. It recommended that dual sourcing of CF-18 parts be implemented wherever possible. DND has reported that the transition to original equipment manufacturers is proceeding well and that contracts with Canadian industry will generate jobs in, and technology transfer to, Canada.

9.31 **Internal audit.** We noted in our 1984 Report that DND's internal audit group had undertaken few audits of major capital projects, and we encouraged the Department to do so. The Department has now established an ongoing program of audits of capital projects and has recently completed its first audit of a major Crown project, the acquisition of the Iltis truck. Another audit involving the Hercules replacement project is under way. Plans are in place for a continuing series of audits of major capital projects, including projects of major crown status.

9.32 **Force structure requirements.** In 1984, we recommended that DND develop and obtain approval for a force structure plan for peace and war. We believe that without such a plan the planning and management of virtually every aspect of the Department is impeded.

9.33 DND had initiated a Normative Planning Project designed to satisfy this need. By 1985 this project had been expanded into a "Defence Policy Implementation Process" intended to present and cost out various force structure options. These options are now being considered as part of Cabinet's White Paper deliberations. As we note later, the need for this kind of policy guidance continues to be felt throughout DND, including in the area of planning for major capital projects.

Results of this Audit

9.34 The following paragraphs discuss our major conclusions arising from our audit of the various life cycle stages of the projects included in this year's review.

Needs Identification

9.35 The absence of an approved force structure continues to complicate planning. Several of the projects we reviewed showed the effects of the lack of an approved force structure. For example, for the Howitzers and Small Arms Replacement projects the number of weapons needed was difficult to define. The number eventually purchased, however, was determined primarily by the funds available and was less than the number specified in DND documents.

9.36 The type of policy guidance needed as the basis for the definition of an approved force structure is now available in the recent White Paper on Defence.

Planning

9.37 Once the identification of needs has been completed, DND engages in a thorough process of defining project requirements, analysing options and specifying project cost, schedule, performance and scope objectives. Our review suggests that these activities are carried out in compliance with the applicable processes and controls, and that significant progress has been made to respond to concerns that were identified during previous audits. Two areas – project scope and cost, and non-military objectives – were the subject of recommendations in our 1984 Report.

9.38 **Project scope and cost**. In 1984, we reported that DND had identified a number of additional capital projects to support the CF-18 project that were being funded outside the CF-18 project. We expressed our concern that it was very difficult to identify what should and what should not be included in the scope of a capital project. The Department agreed with our assessment and has undertaken to clarify its scope statements and to upgrade methods for project life cycle costing. The Department has updated the costs of these associated capital projects and has taken steps to identify those projects that should have been included in the original project life cycle costs. These essential related projects would have cost $2.1 billion in 1984; largely because of inflation, the cost of these necessary projects has grown to $2.7 billion.

9.39 In 1980, the Department initiated a project valued at $368 million to acquire advanced air-to-surface weapons. These weapons were needed to replace 30 year old bombs that were incapable of fulfilling their role. If this project is approved, it could cost as much as $3.7 billion; the increase is largely due to increased cost of weapons, and the expansion of the project to include air-to-air and anti-radiation missiles.

9.40 In 1984 we also reported that some spares and maintenance costs were being charged to operations and maintenance, rather than to the CF-18 project budget. In this year's audit we noted that requirements have been established for two software support facilities. One of these facilities is being funded from the project capital budget. At the time of our audit, the other was to be funded from the departmental operations and maintenance budget; as a result of a recent departmental review, the project has been transferred to the capital budget.

9.41 During this audit we identified a life cycle costing problem with the Howitzer project. Ammunition valued at about $40 million was removed from the project, despite the fact that DND policy states that "full operational stock plus two years training ammunition must be purchased" within the project's budget. The ammunition requirement is being funded through the recurring ammunition purchasing process. As a result, other ammunition requirements are being depressed below their normal two-year level. Another consequence is that this project was not managed as a major Crown project, which is more demanding in terms of approval and reporting requirements.

9.42 These observations reinforce our earlier concerns about the need for clarity in determining what should be included in project scope, improved life cycle costing, and control of project scope and cost changes.

9.43 **Related project objectives.** The long-term employment, industrial development and technological effects of DND's major acquisitions warrant continued attention. Also, DND is embarking on a program to reinforce the strategic sourcing capability of Canada's industrial base. In almost every project we audited, these objectives played an important role in project planning, or in identifying and selecting potential contractors. For example:

- For the CF-18 project, the selection of the systems engineering support contractor was based largely on technology transfer and other economic factors.

- For the Challenger and the Dash-8 purchases, the decision to advance the timing of the projects, and the choice of suppliers were determined to a considerable extent by the needs of the Canadian aircraft industry.

- For the Small Arms Replacement project, the cost of establishing a Canadian manufacturing capability was about $16 million for items such as licence fees, tooling costs and upgrading the manufacturer's facility.

- The shipyard portion of two of the four ships involved in the Tribal Class Update and Modernization Project (TRUMP) was directed to a particular shipyard firm. It has been estimated that there could be an increase in cost should the remaining ships be placed with another shipyard.

- Also for TRUMP, it was decided to discontinue the competitive bidding process and to sole-source the implementation contract, partly on the basis of the urgent needs of the ship-building industry.

- In 1984, we noted that the shipyard construction contracts for the Patrol Frigate project had been split, with three ships to one shipyard in New Brunswick and three ships to two shipyards in Quebec, and that the cost of dividing the work among three companies was estimated by the Department to be $58 million.

- For the Destroyer Life Extension (DELEX) project, an unproven radar was purchased in 1981 from a Canadian firm despite contrary DND engineering evaluations. It now appears that the system will be at least five years late. This significantly impacts on the operational capabilities of the ships involved.

9.44 In our 1984 Report we recommended that industrial benefits be clearly defined for contracting purposes. The Public Accounts Committee further recommended that non-military objectives be identified, monitored and reported in Part III of the Estimates. As we reported earlier, DND has made substantial progress in responding to these recommendations.

9.45 But we are still concerned about the impact that non-military and strategic sourcing objectives are having on planning and implementing these projects, and that their relative weight in decision making and their costs are not clearly defined. For example, in the case of the CF-18 maintenance contract, the Request for Proposal did not indicate to the competing firms that future technological spin-offs would be a major determinant in the selection process. As well, by using industry sector needs as the basis for accelerating projects, overall defence capability goals may not be effectively served.

9.46 In Chapter 10 of this Report, dealing with Materiel Support in DND, we have highlighted a concern related to the need to define "buy-Canadian" goals and objectives and to specify the premium that should be paid to purchase from Canadian rather than foreign suppliers. In a similar vein, our concern with non-military objectives extends beyond just identifying and reporting them; it also includes their cost, impact on project objectives, and consistency of application in the competitive process. To a great degree, these non-military objectives were directed towards satisfying the objectives of other departments, such as the Department of Regional Industrial Expansion, but their costs are charged against DND's budget.

9.47 **Where it is reasonable to do so, the Department of National Defence should determine and report the direct and indirect costs associated with achieving non-military and strategic sourcing objectives, as part of its regular reporting of non-military objectives that now is included in Part III of the Estimates.**

> ***Department's response:*** *Due to the nature of such costs, there are inherent limitations to the ability of the Department to identify all direct and indirect costs associated with achieving non-military objectives. The recommendation will however be implemented whenever possible.*

Implementation

9.48 Our review of this area emphasized aspects of project management, contracting and quality assurance. Once again, our overall assessment is that these activities are carried out in compliance with approved processes and controls. Our review of contracting activities has identified three areas where additional management attention is needed – sole sourcing, payments and warranties.

9.49 **Sole sourcing.** Many of the projects we audited involved sole sourcing to a qualified supplier. The rifles portion of the Small Arms Replacement project was directed to a Canadian supplier, to support Canadian strategic sourcing. The ammunition for this project was sole-sourced to another Canadian firm. The Challenger and the Dash-8 aircraft purchases were largely defined by the needs of the Canadian aircraft industry, and were directed toward pre-selected firms. The TRUMP implementation contract was sole sourced largely to accommodate the urgent needs of the ailing ship-building industry in Canada.

9.50 Treasury Board contract regulations specify that competitive processes are to apply unless a) the need is of pressing emergency in which delay would be injurious to the public interest; b) the expenditure is below certain limits; c) the nature of the work is such that it would not be in the public interest to invite tenders; or d) only one person is capable of performing the contract. For the four projects listed above, the rationale behind the decision to sole source appears to be related to the fact that the nature of the work is such that it was not in the public interest to solicit bids. For TRUMP we requested analyses to support the decision to sole source. But the information we were given did not include any cost-benefit, economic or financial analysis to support the decision.

9.51 These contract regulations were established to ensure, among other things, that the government obtains the optimum combination of quality, time and total life cycle cost. We are concerned about these instances because when the competitive processes are by-passed, the most cost-effective options may not be obtained. For example, in the United States, the Department of Defense has moved aggressively to limit sole sourcing, based on the potential for cost savings through competition.

9.52 The Department of National Defence and Treasury Board should ensure that competitive procedures apply wherever possible. Decisions to by-pass the competitive process should be supported by a full justification in the contract file that specifies the costs, benefits and risks of doing so in comparison to the national benefits expected.

> ***Department's response:*** *The Department supports the use of the competitive process wherever appropriate. An inter-departmental working group, which has been in existence for about two years, is examining this issue with the aim of increasing the use of the competitive process and to identify reasons for non-competition. Additionally, the soon to be promulgated Project Management Manual outlines the policy in this area including the interface with socio-economic benefits that may be associated with direct procurement.*

9.53 **Payments.** Projects of the size included in our audit usually involve both down payments and milestone or interim payments. A number of the projects we reviewed involved either very large down payments, payments in advance of contractual requirements, or payments in excess of contractual requirements. These situations involve a cost to the Crown, unless some form of offsetting compensation is obtained from the supplier. Examples of these payments are:

- For the CF-18 project, the Crown incurred additional interest costs of $7 million as a result of early payments made during 1984 and 1985.
- Also for the CF-18, an additional $4 million of interest costs resulted from higher than necessary milestone payments between 1980 and 1984.
- The Patrol Frigate project involved a $50 million payment in advance of need that cost the Crown $220,000 in interest.
- The Artillery Weapon project involved a down payment of $26.8 million, greater than 50 per cent of the contract value.

- The Challenger project involved a down payment of approximately 80 per cent of the project cost, with no apparent off-setting benefit.

9.54 We noted that in some instances compensation for advance payments was negotiated and received. For example, for the Patrol Frigate project, the contractor agreed to build a support facility at no additional cost to the project. Another example of offsetting compensation is found in TRUMP where, in return for receiving advance payments during the life of the contract, the prime contractor has undertaken to provide an interest credit payment of $31 million (1984 dollars) to the Crown at the end of 1991. In other cases no such off-setting compensation was obtained.

9.55 In 1985, the government introduced a policy of Payment on Due Date, and since then early payments have occurred much less frequently.

9.56 We believe, however, that high down payments, early payments and excess payments should be treated consistently and in a manner that provides adequate compensation to the Crown.

9.57 **The Department of National Defence should establish policies and procedures to ensure that where large down payments, early payments and large milestone payments are necessary, appropriate off-setting benefits are obtained.**

> **Department's response**: *It must be recognized that the negotiation of rates of payments is the responsibility of Supply and Services Canada and that policies and procedures in this area are contained in their publications. However, the Department will establish guidelines for departmental procurement managers on their roles and responsibilities as representatives of a customer department.*

9.58 **Warranties.** Warranties provide protection to the Crown against product fault, discovered either during a project or after it is completed. Warranty protection increases the cost of a project, and the goal, therefore, is to purchase adequate protection at a reasonable cost.

9.59 For highly sophisticated and expensive weapon systems it is a very complex task to define the optimum level of warranty protection or to foresee all possible risks. For example, for the Small Arms Replacement project, DND accepted 12 million rounds of deficient ammunition; it is unclear whether the cost of this ammunition should be covered under warranty. In this case there is also difficulty the Crown penalizing a firm that it has paid to set up and is prepared to subsidize in order to sustain production. In the case of the Patrol Frigate, if the project is completed at the ceiling cost, the Crown can obtain up to $61 million in warranty costs from the prime contractor. This $61 million is also used as a lever to encourage the prime contractor to exercise the warranty provisions it has established with the sub-contractors. Once again, the question arises about whether, under the circumstances, additional warranty protection would have been cost-effective, given the other risk-reduction mechanisms, such as quality assurance, that operate during the production phase. In 1984, we reported that DND had declined the supplier's warranty for the 2 1/2 ton truck; this year we note that the 1/4 ton truck purchased from the same supplier will be covered by a warranty.

9.60 In 1984, we recommended that DND establish a project management system for managing all its major capital projects, and the Department has made substantial progress in this direction. As part of this initiative, guidelines have been drafted for warranty protection, and in co-operation with the Department of Supply and Services, the Department is considering the development of a standardized approach to warranties.

Project Summaries

> Our audit indicates that the management systems and procedures used by DND for major capital and major Crown projects are appropriate. Projects are usually managed in compliance with the requirements of these systems and procedures.

9.61 In the following pages we describe the salient points of each project with comments where appropriate. Where we have concerns they are included in the Observations section at the end of each summary. Where no observations are made, it means that the project met our audit criteria for those life cycle stages covered by this audit, as set out in Exhibit 9.1.

Close Support Artillery Weapon

9.62 **Background.** The Close Support Artillery Weapon project addresses part of the need for artillery to fulfil the operational requirements and commitments of the Canadian Forces. Specifically, the project has provided 26 155mm self-propelled howitzers, 44 tracked support vehicles and 4 armoured recovery vehicles for transporting disabled howitzers.

9.63 The need for this project was defined in large part by the deteriorating condition of existing howitzers and their inability to meet previously defined levels of operational activity. Other factors included the desirability of standardizing equipment and calibre of ammunition used by Canadian and allied forces.

9.64 The total approved budget for the project is $73 million, not including ammunition. The actual expenditure will be $59.7 million, due partly to a departmental decision to acquire rebuilt armoured recovery vehicles at a lower price than new ones, and because contract prices were lower than original estimates.

9.65 **Observations.** The Department initially planned to procure ammunition in accordance with the departmental policy that full operational stock plus two years' training ammunition must be purchased with the weapons. However, ammunition costs initially calculated at $40 million were deleted from the project, and the Department decided to fund this item from the Land Recurring Ammunition Project by depressing other ammunition stocks. This permitted the Department to manage the project outside the major Crown project

An M109, 155 mm self-propelled howitzer in action during a military exercise (see paragraph 9.64).

category, which is more demanding in terms of approval and reporting requirements. Furthermore, the Department identified that the action carried a risk that restrictions on training or operational activity could result.

9.66 The early planning documents identified requirements for the acquisition of 32 105mm towed howitzers and 63 155mm towed howitzers. Later, the quantity of 155mm towed weapons was increased to 80. The final quantity of 26 155mm self-propelled howitzers was considered as satisfying only the most urgent operational commitments. We found no documented risk analysis with regard to the reduction in quantity. There was no documented evaluation of the operational impact.

9.67 The contracting process used in acquiring the equipment followed approved procedures. However, down payments made under the three principal contracts amounted to $26.8 million. This is more than half of the total price of the contracts which amounts to $45.8 million.

Small Arms Replacement Project (SARP)

9.68 **Background.** This major Crown project covers the acquisition of new rifles, carbines and light machine guns (designated as C7s, C8s and C9s respectively), weapon accessories, repair parts and ammunition. These weapons fire the 5.56mm calibre ammunition agreed to by NATO nations. They replace C1 rifles, C2 light automatic rifles and the SMG CIAI sub-machine guns now in service. The total approved budget for the project is $349.1 million.

9.69 Canadian Forces' trials resulted in selecting an upgraded version of the M16 rifle to be built under licence in Canada and the Minimi machine gun to be purchased from a Belgian manufacturer. The carbine is a shorter version of the rifle, also purchased from the rifle manufacturer.

9.70 A contract for the supply of the rifles and carbines was awarded to a Canadian firm with which DSS had entered into a sole-sourcing agreement for small arms work. The additional cost of pursuing strategic sourcing objectives is considered to be about $16 million. Manufacture of rifles and carbines has been progressing on schedule. The contract for the light machine gun was awarded to a Belgian manufacturer, partly as an offset for the Belgian purchase of Iltis trucks from the Canadian manufacturer of these vehicles. Deliveries of the machine guns have been on schedule.

9.71 Project scope has been increased to include optical sights for the rifles and for the light machine guns. These are required to overcome deficiencies in sighting effectiveness discovered during the trials. The cost increase will amount to $34.1 million. The Department considers that this can be paid for within the approved budget. The optical sights were the subject of a separate project until it became evident that the cost could be covered by the SARP budget.

9.72 The new 5.56 mm ammunition is being provided under a sole-source agreement between DSS and another Canadian manufacturer, as part of the government's Munitions Supply Program. An initial contract for 14 million rounds was signed in 1984.

9.73 **Observations.** A serious quality problem affects about 12 million rounds of ammunition valued at $7.5 million. Investigation by DND has revealed that a standard test that would have detected the problem was not carried out by the manufacturer or enforced by the Department. Introduction of the new weapons to Canadian Forces Europe has been delayed one year as a result of the deficiency. The Department has reported that the ammunition is once again in production under improved manufacturing processes and more rigorous testing and inspection. Delivery of 12 million rounds of new, acceptable ammunition has been made on schedule under a new contract. The matter of payment for the replacement ammunition is still under negotiation.

9.74 The quality problem found in the ammunition leads to a concern about who pays for the mistake, given the sole-source contract. There is difficulty in the Crown penalizing a firm that the Crown has paid to set up and is prepared to subsidize in order to sustain production.

Canadian Towed Array Sonar System (CANTASS)

9.75 **Background.** The primary objective of the CANTASS project is to provide improved anti-submarine warfare capability for use on the new Canadian Patrol Frigates under construction, and on the existing destroyers of the DDH265 class.

9.76 Improvements in submarine weapon systems have resulted in the need to detect submarines at much greater distances than the range of earlier detection devices. For these extended distances, the towed array passive sonar systems are now recognized as the most reliable shipboard system. These systems detect the sounds generated by the source as opposed to sound reflection employed in active sonar systems.

9.77 The Department weighed the options and decided to use some system components available from the U.S. Navy combined with electronic signal processing and display equipment to be developed in Canada. Thus CANTASS was initiated in 1982 as a phased development and acquisition project.

9.78 The budget approved for CANTASS is $216 million. It includes $71 million for equipment for the Canadian Patrol Frigate. Procurement and development contracts are progressing on schedule.

Region Operations Control Centres (ROCCs)

9.79 **Background.** This project started in 1973 when the North American Air Defence (NORAD) Command decided to update the existing communications and control equipment in the regional control centres. These centres provide detection and identification of impending air attack. The old equipment was vacuum tube vintage and was becoming very difficult to maintain.

9.80 The American technical program was expanded to include a reconfiguration of NORAD regional boundaries. In 1974, Canada and United States agreed to a reconfiguration that provided for two regions in Canada, four in the continental United States and one in Alaska. Each region would have a command and control centre.

9.81 In developing the requirements for modernizing and expanding the system, several equipment alternatives and siting options were studied. It was decided that Canada would work jointly with the United States to develop and acquire state-of-the-art technology that would be common for all seven Control Centres. Based on a cost analysis, it was also decided to co-locate both Canadian centres at North Bay. The total estimated cost of the project was $95.8 million. Despite the fact that the project was less than $100 million, the Department decided to manage it as a major Crown project, and to accept the increased control and visibility that this requires.

9.82 The requirement for common equipment did not permit Canada to pursue competitive bids. The United States Air Force contracted with an American company to provide the required computer equipment and software. Through a negotiated Letter of Agreement, Canada participated in this contract for the supply of the same type of equipment for the two Canadian Regional Operations Control Centres.

9.83 The communications facilities to connect the centres to the radar installations in Canada are provided by the Trans-Canada Telephone System, with Bell Canada acting as the co-ordinator and system manager. This is covered by a separate communications contract. There was a major delay with the communications contract because the American supplier of the communication switchgear could not deliver until three years after the required date. As a result of initiatives taken by the DND project manager, a solution was found and suitable replacement equipment for the Canadian centres was obtained on time and within the budgeted costs.

9.84 The project was completed on schedule and under budget in late 1982. An evaluation test was conducted by the Tactical Air Command of the United States Air Force in 1983. This test demonstrated that the centres can fulfil their operational requirements.

North Warning System

9.85 **Background.** In April 1982, DND and the United States Department of Defense agreed on an Air Defence Master Plan that called for a perimeter surveillance system covering all approaches to North America. One segment of this system is the North Warning System (NWS), consisting of approximately 11 staffed long-range radar sites and 36 unstaffed short-range radar sites in Canada, with an additional 2 long-range and 3 short-range sites in Alaska. Wherever feasible, the long-range radar sites are to be situated at or near the existing Distant Early Warning (DEW) sites and extend southward at three new sites along the east coast to overlap coverage with the American Over The Horizon - Backscatter extra-long-range radar site in Maine.

9.86 Threat assessment studies established that an early warning system covering the northern boundaries of the continent is essential. Accordingly, the North Warning System was designed to meet the need for contiguous surveillance coverage to ensure detection of unfriendly bombers or cruise missiles. The existing DEW line, because of the smaller number of sensors and the basic design of the equipment, cannot provide contiguous surveillance, and the CADIN-Pinetree radars are obsolete and, in most cases, no longer needed.

9.87 A study of the options available for the defence of North America concentrated on how to react to an attack. All these options included the NWS as the only practical surveillance system in the north.

9.88 Negotiations between Canada and the United States led to a Memorandum of Understanding that provided a cost-sharing ratio of 40 per cent to Canada, 60 per cent to the U.S. As far as possible, this would be accomplished by sharing the work rather than exchanging money. It was agreed that Canada would construct the sites and supply the communication system, and the U.S. would supply the radar equipment. The long-range radars were standard radars already in use. The short-range radars are now in the final development stage.

9.89 The need for this system was well documented and in accordance with the Department's established objectives.

9.90 The total Canadian cost of the system is estimated at $829 million budget-year dollars, with completion scheduled for the end of 1991. Contracts have been awarded for the communications services ($118 million), and design and construction work at three east coast sites ($90 million). All contracts followed the prescribed procedures and are being carefully monitored.

9.91 An interesting variation being used on this project is that project management services have been contracted rather than being provided in-house. This has enabled the project to proceed much faster than usual. It is particularly important because of the short construction period in the north and the urgency being applied to the project. The initial period (14 months) of this contract will cost about $5 million with the full cost estimated to be roughly $35 million for the life of the project.

Tribal Class Update and Modernization Project (TRUMP)

9.92 **Background**. A program intended to upgrade and modernize the surface capability of Canada's navy was presented in a discussion paper to Cabinet in 1977. The paper identified, among other things, a need to conduct a major modernization of the four Tribal Class destroyers. This initiative is referred to as the Tribal Class Update and Modernization Project, or TRUMP. It was proposed that the enhanced Tribal Class capabilities should complement those of the Canadian Patrol Frigate, and that these two classes of ships would form the nucleus of Canada's surface naval force in the 1990s. The project involves a mid-life refit and the replacement of old equipment with modern capabilities such as air defence missiles and a new command and control system.

9.93 In July 1983 Cabinet gave approval in principle for TRUMP at an estimated expenditure of $650 million (1983 dollars) and directed that the shipyard portion of the project would be given to a specific shipyard that was not involved in the construction of the Canadian Patrol Frigate. In May 1986 Cabinet announced that this shipyard would be given the shipyard portion of the project for the first two ships, with the last two put to open competition. Discussions with the Project Management Office staff indicated that, if the last two ships were awarded to another shipyard, there could be a cost increase based on the possible duplication of support requirements and the loss of learning curve benefits. The actual cost, if any, will not be determined until the tendering process is completed in early 1988.

9.94 In January 1984, Treasury Board authorized spending up to $17.41 million for the TRUMP Definition Phase. Three bids were received for the contract to undertake the Definition Phase - one of $7.9 million, one of $10.7 million and one of $12.9 million. All three were considered to be in compliance with technical requirements. An evaluation of these

HMCS Athabaskan, one of the four Tribal Class destroyers to be modernized by TRUMP, at sea with one of its Sea King helicopters in operation (see paragraph 9.92).

proposals was conducted in April 1984, and the evaluation team ranked the proposals in the order shown above. An agreement was signed with the selected (lowest) bidder in June 1984 to begin the Project Definition work right away. Between June 1984 and April 1986, Treasury Board approved three amendments to the contract, the last of which raised the total contract price to $19 million. Part of the rationale for the third amendment was the need to help the contractor retain engineering personnel and technical staff capabilities, presumably to permit carrying out the implementation phase of the project, despite the fact that no agreement had yet been made that that contractor would, in fact, be chosen.

9.95 Following completion of the project definition phase, DND and DSS recommended, and in April 1986 Treasury Board approved, a contract with the same contractor for the implementation phase of TRUMP at a total estimated cost of $1.3 billion budget-year dollars. This contract, signed on 9 May 1986, was awarded without a request for bids from other potential bidders.

9.96 **Observations.** We have been unable to obtain any financial or economic options analyses for sole sourcing. We are concerned, therefore, that the action to by-pass the competitive bidding process may have been taken with insufficient cost-benefit analyses. We are also concerned that the decision to sole source the implementation contract may not have been in compliance with Treasury Board policy regarding competitive bidding which is intended, among other things, to ensure that the government achieves maximum economy in the purchase of goods and services. By sole sourcing the contract, DND might not have obtained the most cost-beneficial option.

9.97 The April 1986 decision to discontinue the competitive bidding process on TRUMP and award a $1.3 billion implementation contract to the selected contractor was, according to DSS and DND, done in the national interest under section 8(c) of Appendix F of the Government Contract Regulations. The principal reasons given for this action were:

- to accelerate the contract award and place work with the ailing shipyard industry;
- to avoid a possible $30 million to $35 million interim ship refit cost that might occur if competitive bidding was continued; and
- to avoid placing contracts with any companies already involved with the Canadian Patrol Frigate Project to eliminate the possibility of overburdening that could result in Canadian Patrol Frigate project slippages.

9.98 The objective of Treasury Board regulations and Department of Supply and Services policies concerning competitive bidding is to secure the lowest price from qualified bidders. By not seeking competitive bids for the implementation contract, the project may have incurred additional costs that might offset the benefits achieved. However this could only be determined after careful consideration of the many complex factors involved.

Destroyer Life Extension (DELEX) Project

9.99 **Background**. The Destroyer Life Extension (DELEX) Project was designed to extend the operational life of Canada's 16 active steam-driven destroyers pending their replacement by new ships. All the ships have been repaired in critical areas and have had unsupportable equipment replaced or modified to provide continuing "safe-to-go-to-sea" capability. Ten ships have been furnished with updated equipment necessary to maintain approved combat and communication capabilities. The six oldest ships, which are to be replaced by the new Canadian Patrol Frigates, have received no additional work beyond the "safe-to-go-to-sea" package. No deliberate attempt has been made to increase the capability of the fleet through DELEX.

9.100 In 1978, the Department approved the use of $79.9 million from operations and maintenance funds for the "safe-to-go-to-sea" package. In 1980 Treasury Board approved the capital program for $133.9 million. The project was to be completed by 1986, but the completion date has been set back to 1989-90 because of lack of operations and maintenance funding for refits in 1980-81 and delays in delivery of some equipment.

9.101 We reported in 1984 on the identification, planning and implementation stages of the life cycle. We had found that the identification and planning stages of the project met our audit criteria and that an analysis of available options had been made.

9.102 **Observations**. In 1984 we were concerned with an issue involving a non-military objective when an unproven radar was bought contrary to the recommendations of the Department's technical experts and against a departmental directive to buy "off-the-shelf" equipment. The radar was ordered from a Canadian company largely to support industrial development and Canadian sourcing objectives. In 1984 we reported that the Department was then estimating that the delivery of proven, militarized radars would be three years late. In response to Public Accounts Committee questions in March 1985, the Department responded that the problem was well in hand and that the radars would be less than three years late. But reliability problems have persisted, and the most recent estimate by the Department is that fully approved radars could be five years late. This creates a significant limitation in the capability of those ships involved during a substantial part of their life extension.

9.103 We noted that a new gun fire control system was failing to provide suitable stabilization data in rough seas. At first the supplier claimed that the problem would be eliminated by modifying system software, and the Department considered that correction of the problem was imminent. However, the stability problem has persisted and the supplier has concluded that its correction now requires installing a new reference sensor so that the contractor can match his system to existing shipboard equipment.

9.104 At the time of contract negotiations, DND dropped an option for a sea-going demonstration of the gun fire control system from the requirements in an attempt to save $400,000 (U.S.). It amended the Technical Statement of Requirements to accept carrying out trials of the equipment on board ships alongside dock rather than at sea. The performance was satisfactory alongside dock but not at sea.

9.105 The supplier has sought additional payment for his work in fixing the problem, and the Department has agreed to pay $800,000 (U.S.) as one-half of the claim. Acceptance of performance is now predicated on trials at sea.

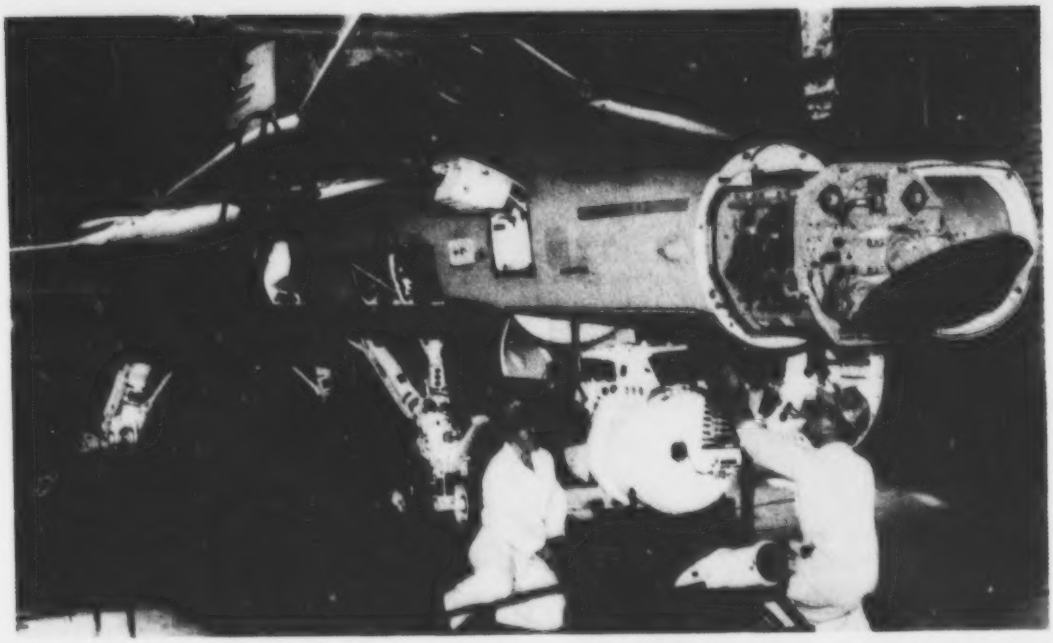
9.106 In the interim, the shortcoming in the new fire control system has reduced the combat capability of the same ships that are affected by the radar problem.

New Fighter Aircraft (CF-18)

9.107 **Background.** In April 1980, Cabinet selected the CF-18 as Canada's new fighter aircraft to replace the fleet of CF-101 and CF-104 aircraft and those CF-5 aircraft committed to NATO. A budget-year ceiling of $5.19 billion was approved for the procurement of 138 aircraft and associated logistic support including spares, maintenance and training equipment.

9.108 In 1984, we reported on the needs identification, planning, and the early stages of the acquisition of the CF-18 aircraft.

9.109 Since 1984, the Department has been heavily involved in introducing the aircraft to its bases in Cold Lake, Bagotville, and Baden. Activities have focused on taking delivery of new aircraft, training pilots and servicing staff, establishing second line support capability, and contracting for third-line maintenance support.



The CF-18 allows quick access to aircraft components for improved maintenance and troubleshooting (see paragraph 9.109).

9.110 A contract was awarded to a consortium of Canadian companies in October 1986 to establish in Canada a system engineering support capability and airframe repair and overhaul services for the CF-18. Cabinet gave approval of expenditures up to $104 million. This is based on estimates of the activities expected during the first four years of the contract.

9.111 Installation of a weapons software support facility is nearing completion at the Canadian Forces Base at Cold Lake, Alberta. This is the first of two software support facilities identified by the Department as being essential to supporting the CF-18 weapon system. The Department has estimated the cost of each facility to be approximately $45 million.

9.112 A design defect that resulted in cracks in the area of the vertical tail assemblies of the aircraft became evident in 1984. The manufacturer subsequently arranged for the repair and modification of all aircraft in the field. During that period, the Project Management Office refused to accept delivery of new aircraft until the necessary modifications were completed at the factory.

9.113 In response to a directive from Treasury Board, the Project Management Office prepared a revised Project Brief to define more clearly those items that were being procured within the main project. Treasury Board approved the revised Project Brief in February 1985.

9.114 Delivery of the last aircraft is scheduled for September 1988. The Department estimates that the project will be completed within the approved budget.

9.115 **Observations.** The CF-18 Prime Mission Vehicle contract requires payments to be made within 30 days after accomplishment of certain events and the receipt of the contractor's invoices and supporting documents. Payments to the contractor may be made at a bank in Ottawa designated by the contractor. This enables the Department to take full advantage of the 30-day payment period. However, our review indicated that some payments were made in advance of due dates. As a result, the Crown incurred an avoidable interest cost of approximately $7 million, based on Treasury Board rates and formulae. The Department told us that, in fact, this frequently occurred in projects of this type because of a government policy to expedite payments. In August 1985, the government introduced a different policy of Payment on Due Date, and since then payments have been made on the due dates.

9.116 The Prime Mission Vehicle contract provides for milestone payments to be made against approved invoices for 120 per cent of target costs for work scheduled to be completed at the time of payment. The contract also provides that these payments may be reduced if the payments to-date will exceed the sum of actual costs and allowable profit. We found that payments exceeded actual costs and profits between April 1980 and August 1984 without any reductions being made in milestone payments. As a result, the Crown incurred further interest costs of approximately $4 million during this period. Since August 1984, contractor reported costs and profits have consistently exceeded DND payment amounts.

9.117 In 1984 we also reported on the audit provisions of the aircraft contract, and we expressed concern about the adequacy of the direction that the Department of Supply and Services had provided to the United States Defense Contract Audit Agency (DCAA) to verify the validity of costs recorded by the contractor. We have since found that significant improvements have taken place in the audit coverage provided for the aircraft contract and in the information reported by DCAA to DSS.

9.118 We reviewed the planning documents for acquisition of software support. The requirement for a software support facility was identified in the 1979 CF-18 Project Brief. When funding for this project was approved, the design and cost for a software support facility was not defined because sufficient information was not available. Since then, a requirement for a second software support facility has been developed. The set-up of each facility is estimated to cost in excess of $45 million. The weapon system software support facility is funded through the CF-18 project budget, but the electronic warfare software support facility was designated for funding from the departmental operations and maintenance budget. Projects of this type are capital in nature and proper, consistent treatment would require both facilities to be funded from the CF-18 capital budget. Following a departmental review, it was decided to fund the second facility from the departmental capital budget. We are concerned that projects of this nature are being funded from funds outside the CF-18 project and that the cost of the CF-18 project is therefore being understated.

9.119 We reviewed the contracting process for awarding the implementation contract for the weapon system software support facility. We found that the management practices employed were satisfactory.

9.120 In December 1983, Treasury Board directed that the 1979 CF-18 Project Brief be updated because the Ministers had expressed concerns about the visibility and accountability for the total cost of acquiring the entire CF-18 weapons system and about the clarity of the baseline against which the performance and costs of the CF-18 project are to be measured. In our 1984 Report we also expressed concerns that the 1979 Project Brief did not specifically and clearly define the requirements to be purchased from the project budget and those to be purchased from operations and maintenance. In February 1985, the Public Accounts Committee also expressed concern over this.

9.121 In February 1985, a revised CF-18 Project Brief was approved by Treasury Board. The revised Brief further clarified the items to be acquired both inside and outside the project budget. In our review of the revised Project Brief we noted that the project budget will procure spares to support the first three years of initial operations and follow-on purchases will be made from the operations and maintenance budget; the project budget will procure some aircraft maintenance support equipment for contracted maintenance for the first two years of operations when the manufacturer was providing contracted maintenance; technical data required for setting up and operating third level maintenance would be procured from the operations and maintenance budget; and the project budget would provide for certain stated major construction projects but would not include possible construction of additional quarters, or for modifications or facilities except for those located at the three main operating bases for the CF-18 aircraft.

9.122 In our 1984 Report we noted that the Department had identified a number of associated capital projects related to but not included in the CF-18 purchase. We also noted that these range from items considered indispensable to those classed as highly desirable for procurement if funding permits.

9.123 The explanation of the need for these projects, as stated in the revised CF-18 Project Brief approved in February 1985, confirmed our 1984 Report assessment of the priority of these projects. This Brief also identified that the costing data provided for most of these projects would be subject to amendment as the projects move through the departmental approval process. Our review of the acquisition status of these projects indicated a number of minor additions and deletions.

9.124 The Department has updated the costs of these associated capital projects, and has taken steps to identify those that should have been included in the original life-cycle costs. These essential related projects would have cost $2.1 billion in 1984; largely because of inflation, we now estimate these additional costs to be $2.7 billion. To date, less than $500 million has been approved by Treasury Board and another $2.2 billion has departmental planning approval.

9.125 In 1980, the Department initiated a project valued at $368 million to acquire advanced air-to-surface weapons. These weapons were needed to replace 30-year-old, time expired bombs that were no longer capable of fulfilling their role. The Department has updated the cost of this separate project at $3.7 billion. The increase in cost is largely due to increased cost of weapons, and expansion of the project to include air-to-air and anti-radiation missiles.

9.126 In our review of the contracting process for the system engineering support capability we found that the technical and financial evaluations of the bid submissions were comprehensive. There were three consortia of companies participating in the final bid. The interdepartmental evaluation team rated one bid to be superior in meeting project requirements, and lower in cost than the second bid. The third bid was judged technically unacceptable. All three proposals satisfied the single socio-economic criterion stipulated in the Request for Proposal.

9.127 Consequently, the CF-18 Senior Review Board agreed with the recommendation that the contract be awarded to the leading consortium. This recommendation was then submitted to the Ministers of the Departments of National Defence, Supply and Services, and Regional Industrial Expansion. However, after their review, a submission was prepared by the Department of Supply and Services recommending that the contract be awarded to the group ranked second by the evaluators. Treasury Board gave its approval to this submission.

9.128 The President of the Treasury Board subsequently explained that the Government had made a very deliberate choice to favour the selected firm because it was felt that downstream technology transfer could be better done through the existing facilities of that firm which is a producer of aircraft as well as being in the maintenance business.

9.129 The terms and conditions of a Memorandum of Understanding signed by the aircraft manufacturer and the Departments of National Defence, Supply and Services and Regional Industrial Expansion cover the transfer of technology for use only on the CF-18 weapon system. Similarly, the Licence and Technical Assistance Agreement being negotiated between the manufacturer and the selected consortium is limited to the CF-18. Should this consortium wish to use the technology for other purposes, additional licensing agreements will have to be negotiated with the proprietors of the technology. The cost of these additional arrangements is not known.

Navigator Trainer and Transport Aircraft (Dash-8)

9.130 **Background.** This project was originally part of a larger project established in 1981 for replacing the several types of aircraft in the Department's fleet of medium multi-engined aircraft. It was to be implemented in the mid-1990s. That project also would permit redeploying, to their originally intended roles, four Hercules transport aircraft used for navigator training. No funds were to be provided in the Defence Services Program until 1991.

9.131 A separate project was established in 1984 to purchase Dash-8 aircraft to meet pressing needs of the aircraft industry for sales at that time.

9.132 The need for the aircraft can be clearly related to departmental roles and objectives. The type and level of service and the characteristics of the aircraft were reasonably well defined. But they were generally based on the premise of replacing an equivalent number of aircraft.

9.133 During 1982 and 1983, a number of meetings and informal reviews were held to consider the suitability of Canadian manufacturers' aircraft for various departmental roles. Early in 1984, an Interdepartmental Working Group on the Dash-8 program was established chaired by the Department of Regional Industrial Expansion. These initiatives resulted in a decision to purchase six Dash-8 aircraft that would permit the redeployment of the four Hercules used for navigator training and replace two Dash-7s used for light transport at Canadian Forces Europe.

9.134 Treasury Board project approval was obtained in August 1984 for a total expenditure of $98 million including spares, maintenance support and training. The navigator trainer aircraft project also included the development of integrated airborne and ground navigator training stations.

9.135 A contract was negotiated and awarded to the manufacturer in August 1985 for six aircraft plus training and publications at a firm fixed price of $77.5 million. The spares and maintenance were to be contracted separately when requirements were determined.

9.136 The contract provided for a down payment on execution of $23.1 million representing approximately 30 per cent of the total value. The remainder of the payments were based on milestones related to the progress of the work. To accommodate the Department's funding requirements, two of the milestone payments were subject to the additional condition that they were not payable before 1 April 1986 and 1 April 1987.

9.137 Deliveries of the first two aircraft, originally scheduled for April and June 1986, were delayed for almost a year because of the complexity of producing aircraft to meet DND requirements and because of labour and production difficulties.

9.138 **Observations.** The normal review procedures in the Defence Program Management System for establishing departmental priorities were not followed. Under certain conditions the competitive bidding procedures normally required by the Government Contract Regulations can be waived. The conditions surrounding this acquisition were deemed to fall within these provisions. These aircraft were bought contrary to the Department's planned priorities for equipment acquisition.

9.139 The aircraft selected met the specified needs but the analysis of alternatives was limited to a confirmation that the Canadian product was suitable and that the socio-economic benefits outweighed any potential differences between Canadian and foreign built aircraft.

Challenger Aircraft

9.140 **Background.** This project was established to acquire 12 Challenger aircraft at an estimated total cost of $211.2 million to meet three separate Department of National Defence requirements. Four of the aircraft were Challenger CL601s, for replacing executive airlift aircraft referred to as administrative flight services. Seven were Challenger CL600 aircraft for use as electronic warfare training aircraft, referred to as electronic support and training systems. One was the Challenger CL600 prototype for use as an avionics test bed aircraft.

9.141 The departmental requirement to replace administrative flight services aircraft was reasonably urgent, given a result of the government decision in November 1984 to consolidate the DND and Department of Transport executive airlift operations. The requirements for seven dedicated electronic warfare training aircraft and an avionics test bed aircraft were on a DND list of unaffordable projects. None of the projects had progressed through the normal review procedures in the Defence Program Management System to a point where funds had been allocated to them.

9.142 At the time, the manufacturer had four unsold Challenger CL601 aircraft nearing completion on its production line and eight used Challenger CL600 aircraft, including the Challenger prototype, in inventory. During this period, the government was in the process of divesting itself of the two Crown-owned aircraft manufacturers.

9.143 Early in 1985, the Department of Regional Industrial Expansion was proceeding with a Supplementary Estimate for $140 million as an equity contribution to the manufacturer. About the same time, DND was proceeding with a Treasury Board submission for the purchase of four Challenger CL601 aircraft for the administrative flight service. A series of high-level interdepartmental meetings on the question of assistance to the manufacturer resulted in a decision by Cabinet on 28 February 1985 to purchase up to 12 Challenger aircraft.

9.144 The characteristics and numbers of the aircraft were subject to detailed analysis and were adequately defined. The selection of the aircraft was generally consistent with the requirements. But a major part of the analysis of alternatives was directed to assessing the suitability of the aircraft available from the Canadian manufacturer.

9.145 Treasury Board project approval was obtained on 8 March 1985 for a total cost of $211.2 million. DND was to be provided with $140 million for the project in Supplementary Estimates for 1984-85. The project was also exempted from the additional Treasury Board project management requirements for major Crown projects. A contract was negotiated and awarded to the supplier on 28 March 1985 for the purchase of the 12 aircraft at a firm fixed price of $183.0 million.

9.146 A down payment of $140 million was paid on the signing of the contract. An additional amount of $7.7 million was payable as CL601 aircraft were delivered to the completion centre for finishing. The remainder of the contract was payable as the finished aircraft and other items were delivered to DND.

The purchase of Challenger aircraft is intended to enhance the capabilities of the Canadian Forces with respect to electronic warfare, avionics testing and administrative airlift (see paragraph 9.142).

9.147 The large down payment was due to the advanced stage of completion of the aircraft and the need to ensure the funds were disbursed prior to 31 March 1985.

9.148 Deliveries of the administrative flight service aircraft, originally scheduled for January to March 1985, were delayed for periods from 7 to 10 months. The other aircraft were also delayed by similar periods. The Crown took legal action in May 1986 under the Breach of Contract provision to force the contractor to exercise better control over the contract.

9.149 An amount of $480,000 was negotiated as a credit for the cost to the Department of the delays. The credit is to be used for purchasing additional spare parts, repair services or other services.

9.150 A decision was made in July 1985 to increase the level of spare support for the administrative flight service from a normal commercial operator dispatch reliability rate of 95 per cent to a "blue ribbon" level of 99 per cent. The total cost of the additional spares for the increased level of service was estimated at $16 million, of which approximately $8 million was to be charged to the Challenger acquisition project.

9.151 **Observations.** The decision to purchase the aircraft from the Canadian supplier precluded any opportunity to use competitive bidding procedures as required by the Government Contract Regulations.

9.152 An amount of $27.2 million was improperly charged to 1984-85 expenditures when the cheque for $140 million was issued at the signing of the contract on 28 March 1985. The amount should not have been charged to the 1984-85 fiscal year since it was a holdback that was not due until the aircraft were delivered either to the completion centre or to the Department. This didn't happen until after 31 March 1985.

9.153 Most of the aircraft were bought contrary to the Department's planned priorities of equipment acquisition. Although eight aircraft can be linked to Department of National Defence broad roles and objectives, the decision to acquire them in February 1985 was made primarily to provide financial assistance to the manufacturer prior to 31 March 1985. As we reported in 1984, because DND does not have an approved force structure plan, it is not possible to assess the extent to which projects such as this satisfy clearly defined needs.

The Canadian Patrol Frigate (CPF)

9.154 **Background.** In December 1977, Cabinet authorized a $63 million project definition study for Phase 1 of a ship replacement program. Phase 1 involved the acquisition of six ships. Our 1984 Report reviewed the Identification and planning phases of the life cycle of Phase 1. The focus of this audit was on the implementation stage of this project.

9.155 The objective of the Canadian Patrol Frigate project is to provide six fully supported frigates within the terms of the contract and on schedule, with delivery of the first ship in 1989 and the last ship in 1992. Treasury Board approval was received 25 July 1983, and the contract was signed on 29 July 1983. The total cost is to be within the approved ceiling of $5.5 billion (budget-year dollars). This figure consists of about $1.2 billion for the cost of government activities and $4.3 billion for the contract work.

9.156 The project is in the hands of a Canadian prime contractor, with two major subcontractors responsible for integrating the combat systems and constructing and outfitting of three of the ships.

9.157 The contract provides for a number of incentives and penalties related to cost performance, scheduled deliveries, ship performance parameters and industrial benefit undertakings. The warranty provisions state that

- the ships are to be free from all defects in design and workmanship for one year after delivery and acceptance;
- the leadship will be free from all faults or defects in design for a period of two years after the delivery and acceptance of the leadship;
- the leadship will perform in accordance with all performance requirements contained in the specifications for two years after delivery and acceptance of the leadship; and
- the five other ships will perform in accordance with all performance requirements for one year after delivery and acceptance of the last ship.

9.158 The first ship, the *Halifax*, is under construction. Fabrication began in May 1986, and the first units such as the keel and the structure immediately above the keel have been completed and put in drydock. Float-up, which is the completion of the ship's hull structure and outfitting is due in January 1988 - with delivery of the *Halifax* to DND scheduled for October 1989.

9.159 **Observations.** We have a concern with the warranty as it now exists. The contractor is obligated to pay only 80 per cent of warranty claims that exceed the contract ceiling up to the warranty limits of $18 million for defects in material and workmanship and $43 million for design. Once these warranty limits have been reached, the Crown must pay 100 per cent of all warranty costs. The potential risk to the Crown could be substantial. If the project is completed at the ceiling cost, the Crown will be liable for all warranty costs above $61 million.

9.160 DND states that warranty provisions apply only after a comprehensive trials period, and provision was made within project contingency funds (about $400 million) for unforeseen difficulties such as unexpected price rises and warranty expenditures. Also, the warranty with the prime contractor can be used as leverage to encourage the prime contractor to exercise warranty arrangements it has made with the various sub-contractors.

9.161 Our review of the project monitoring and control systems indicates that they are adequate. However, there are about 150 items in the software development process that are behind schedule in part because of a lack of clarity in the specification of software requirements. To get back on schedule, steps have been taken to clarify the requirements, and work is proceeding in parallel with this, where possible. Nevertheless, the area must be closely tracked to ensure that the schedule is met and costs are controlled. This process has taken approximately four months and is near completion. But this may further delay the Canadian Patrol Frigate Project with possible increases in costs. DND suggests that the delay in software development is due to start-up difficulties and an ambitious schedule, and that current projections are that the project will be completed on time and within the contract ceiling price.

9.162 We also have some concerns about milestone payments. The contract for the Patrol Frigate requires milestone payments "no later than April 15, 198X." A cheque for the second of these annual payments was issued 15 April 1985 and charged to the old year. The authority quoted for this action was a 27 July 1983 Treasury Board letter that contained permission to disburse advance payments ahead of schedule to facilitate the cash flow management needs of the Department. However, the charge to the old year is questionable because the payment was not disbursed until the new year. The Government's Payment at Year End directive allows an advance to be recorded as a charge to the old year only if it was due on or before 31 March. The term "no later than April 15" does not satisfy this requirement. This matter was reported as part of the Office's Year-end Payments Study in 1986.

9.163 A $50 million partial payment of a $74 million milestone payment, due no later than 15 April 1986, was paid 26 March 1986. If the Crown borrows money at the rate of 8 per cent, this early milestone payment would have cost the government about $220,000. Proper cash flow management suggests that the advance should have been paid on 15 April 1986, or $220,000 deducted from the $50 million payment when the Department paid the money earlier than was necessary so as not to confer an interest benefit to the contractor and a loss to the Crown.

1 1/4 Ton Truck Project

9.164 **Background.** The purchase of 1 1/4 ton trucks is one component of a Military Operational and Support Trucks Project that deals with all logistic wheeled vehicles. It includes planning and implementing of the acquisition of replacement fleets.

9.165 Replacement of the 1 1/4 ton truck fleet had been planned for the early to mid 1980s, but funds were not available to satisfy all project requirements. So replacement of this fleet had to be postponed until the early 1990s. In the meantime, approval was given to a refurbishment project to extend the life of the 1 1/4 ton truck fleet until new replacements are provided.

9.166 The 1 1/4 ton truck fleet consists of 2,836 four-wheel drive commercial trucks that were acquired in 1976. They had an economic life expectancy of eight years. By 1982, significant corrosion was evident, and an investigation made by independent consultants concluded that the main structure of the trucks was basically sound and that the life of the fleet could be extended to 1990 by patching over corroded areas and making some simple improvements for reinforcement and to protect against structural deterioration.

9.167 In 1983, a DND Senior Review Board decision approved the refurbishment project and the purchase of a life-time supply of spare parts that were being phased out of production by the manufacturer. The patching and product improvements were to be funded out of operation and maintenance funds with a budget of $6.3 million. The purchase of spare parts was estimated at $9.5 million and was to be made from capital budgeted for the original acquisition project in 1976. The implementation of the refurbishment was carried out in accordance with approved procedures.

9.168 The approach used to determine and report on the operational availability of the fleet is largely judgemental and varies from base to base. We were therefore unable to express an opinion on the integrity of the operational availability reporting system of the fleet because of the lack of consistent predetermined criteria for measuring availability.

9.169 **Observations.** Because of the effects of road salt, there was a noticeable disparity in the condition of trucks used in different parts of the country. Also, as shown in a departmental report prepared in 1983, there was a great difference in mileage accumulated from vehicle to vehicle; in fact, the difference varied from less than 600 miles to more than 80,000 miles. Both of these conditions indicated that the fleet had not been rotated in accordance with Canadian Forces' normal practice. The fleet was rotated in 1984-85, but DND has estimated that by not doing so previously on a regular basis, maintenance costs of $6 million were incurred earlier than necessary. And some vehicles had to be disposed of

2,500 new 1/4 ton trucks (Iltis vehicle) are part of Canada's Military and Operational Support Trucks project, designed to provide land forces with adequate ground transportation (see paragraph 9.175).

because they were not economically repairable. This consequence has contributed to a shortfall of vehicles available for operational requirements.

1/4 Ton Iltis Truck Project

9.170 The 1/4 Ton Iltis truck project is the first in the major Crown project category to be audited by the Department's internal audit group. We carried out a number of tests to confirm compatibility with our audit approach and concluded that the work was appropriate and reliable.

9.171 **Background.** The purchase of 1/4 ton trucks is a component of the Military Operational and Support Trucks (MOST) Project which deals with the Canadian Forces' requirements for all logistic wheeled vehicles.

9.172 Iltis is the vehicle selected to replace the Jeep and Jeep-type 1/4 ton vehicles which had reached the end of their economic lives.

9.173 The Iltis is a European designed vehicle that has been used for several years by the West German army. It was chosen by the Canadian Forces over a selection of other vehicles because of design and socio-economic considerations and benefits.

9.174 Manufacturing rights were obtained by a Canadian company from the original equipment manufacturer with some design modifications made to suit the Canadian Forces' requirements. The basic vehicles have been produced in Canada and Canadian manufactured components have been substituted for foreign sourced items wherever possible.

9.175 Final Treasury Board approval was given in July 1985 for the acquisition of 2500 vehicles, special kitting and spare parts at a ceiling cost of $115 million (budget-year dollars). The project is scheduled to be completed by December 1987. Current departmental estimates show that total expenditures are expected to be $110.2 million (budget-year dollars).

9.176 **Observations.** The contract terms for the Iltis vehicle have not adequately protected DND's interests. They have not provided a basis to negotiate recovery of additional foreign exchange costs attributable to late deliveries or to provide recompense for late delivery of spare parts. DSS officials advise that the prime contractor would not agree to provisions covering damages due to late delivery or exchange rate fluctuations in regard to the spare parts.

9.177 Some spare parts procured from off-shore sources have been delivered almost one year later than scheduled, despite the fact that the contract did not allow for price increases beyond those in force at the planned delivery date. In the meantime, the exchange rate for the foreign currency involved had increased steadily and the spares were paid for at the higher rate. The internal audit group has calculated that an additional cost of at least $377,000 was incurred because of the increase in exchange rates between the scheduled and actual delivery dates.

9.178 Legal counsel concluded that there is no basis for obtaining any adjustment in price since the rate of exchange was not time-specific; that is, it was not tied to contract schedule dates.

9.179 Because of this and the absence of any penalties for late delivery of spare parts, there was reduced incentive for the supplier to meet schedule dates.

DEPARTMENT OF NATIONAL DEFENCE
MATERIEL SUPPORT

DEPARTMENT OF NATIONAL DEFENCE
MATERIEL SUPPORT

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10

DEPARTMENT OF NATIONAL DEFENCE MATERIEL SUPPORT

Introduction

10.1 Under the pressures of war, the ability of Canada's armed forces to survive and to succeed in carrying out their assigned tasks will depend on a number of factors. These include leadership, the quality and training of our people, the number and technological sophistication of major equipment items, and the effectiveness of the command, control and information arrangements. A less obvious but equally important factor is the support given to the fighting units to feed the troops, maintain equipment, replenish ammunition, care for and evacuate the wounded, and bring forward replacements of people and equipment for those lost in battle. If this support fails or is inadequate, the capability of the fighting units will quickly diminish as equipment becomes inoperable, battle losses reduce the size of troop formations, and essential combat supplies dwindle. This support is referred to as "logistics".

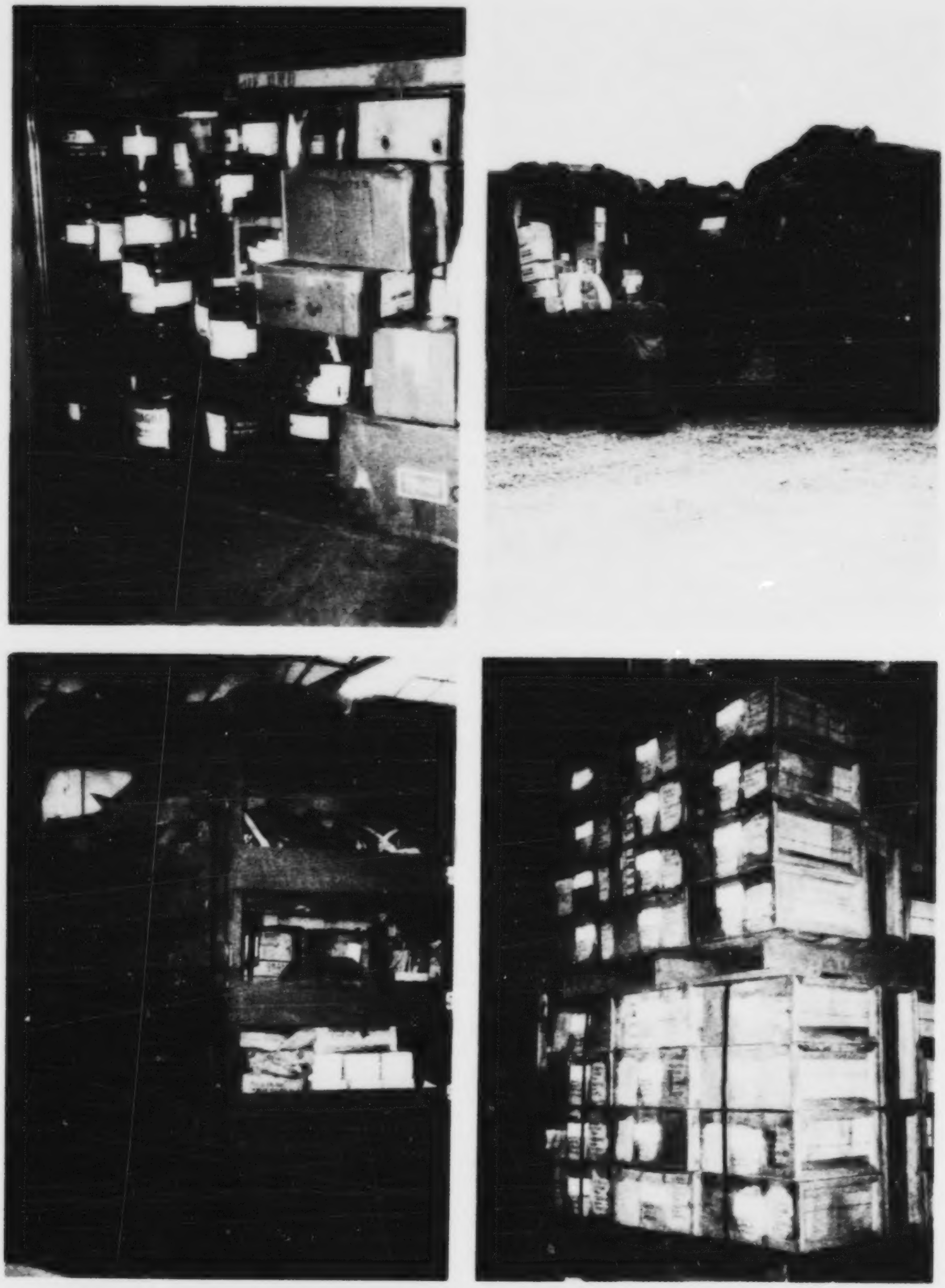
10.2 Logistics involves the acquisition, maintenance and transportation of both people and materiel. Materiel support is a Canadian term which describes that portion of logistics dealing only with materiel. In simple terms then, materiel support involves the integration of the supply, maintenance and transportation of materiel.

10.3 The basic structure within which materiel support is provided has its foundation in support doctrine. This in turn is based on certain concepts of operations. Doctrine is a set of fundamental principles by which the military guides its operations.

10.4 The logistics pipeline through which materiel support is provided is large and complex. It consists of several segments stretching from suppliers to the fighting troops, wherever they may be located. It could be several thousand kilometers long and involve multiple redistribution points. The scale of operations within an allied army group, for example, can involve over a hundred thousand soldiers, tens of thousands of vehicles and many hundreds of thousands of kilograms of supplies.

10.5 Within the theatre of operations, the pipeline is the responsibility of the operational commander. We have called the pipeline extending behind the operational commander to the suppliers "strategic support".

10.6 Even during peacetime, an enormous level of resources is acquired, maintained and transported through the materiel support system. During 1986-87, the Department spent over $1.3 billion replenishing an inventory consisting of close to 1.3 million different items. Over 10,000 people are assigned to the materiel support activity as it is defined in Part III of the Estimates. These personnel are employed primarily in supply, engineering and maintenance activities. DND estimates the value of the inventory held at bases and depots to be $7.5 billion in terms of historical cost.



In wartime, thousands of kilograms of supplies could be constantly on the move within an area of several thousand square kilometres (see paragraph 10.4).

10.7 At present, support is provided through a number of facilities including four main supply depots, three specialized depots and four ammunition depots. Supplies then flow through bases, stations and sites (each of which may involve a number of separate buildings and supply accounts) where they are issued to requesting units. Materiel support elements managed by Headquarters also include five large engineering test establishments, used to test and qualify equipment, as well as a major repair facility for land equipment and a maintenance development unit for air equipment. Maritime equipment is supported on the east and west coasts by two Ship Repair Units which are part of the materiel support function managed by the Commands. In addition to these major establishments, the materiel support system comprises a number of other facilities such as research establishments and postal units.

Previous Audit Activity

10.8 We reported our first comprehensive audit of the Department of National Defence in 1982. In that audit we focused on major management functions. The report also touched on the need for improving many automatic data processing systems, including the Canadian Forces Supply System.

10.9 In 1984, we reported on the overall management process of the Department, the military personnel planning system, selected major Crown projects and certain aspects of materiel support. To date, however, the entire system of materiel support or logistics has not been examined as a critical and complete entity within the Department.

10.10 Many of the recommendations contained in our 1984 chapter on DND directly or indirectly affect materiel support. DND has moved aggressively to respond to our recommendations and to those of the Public Accounts Committee.

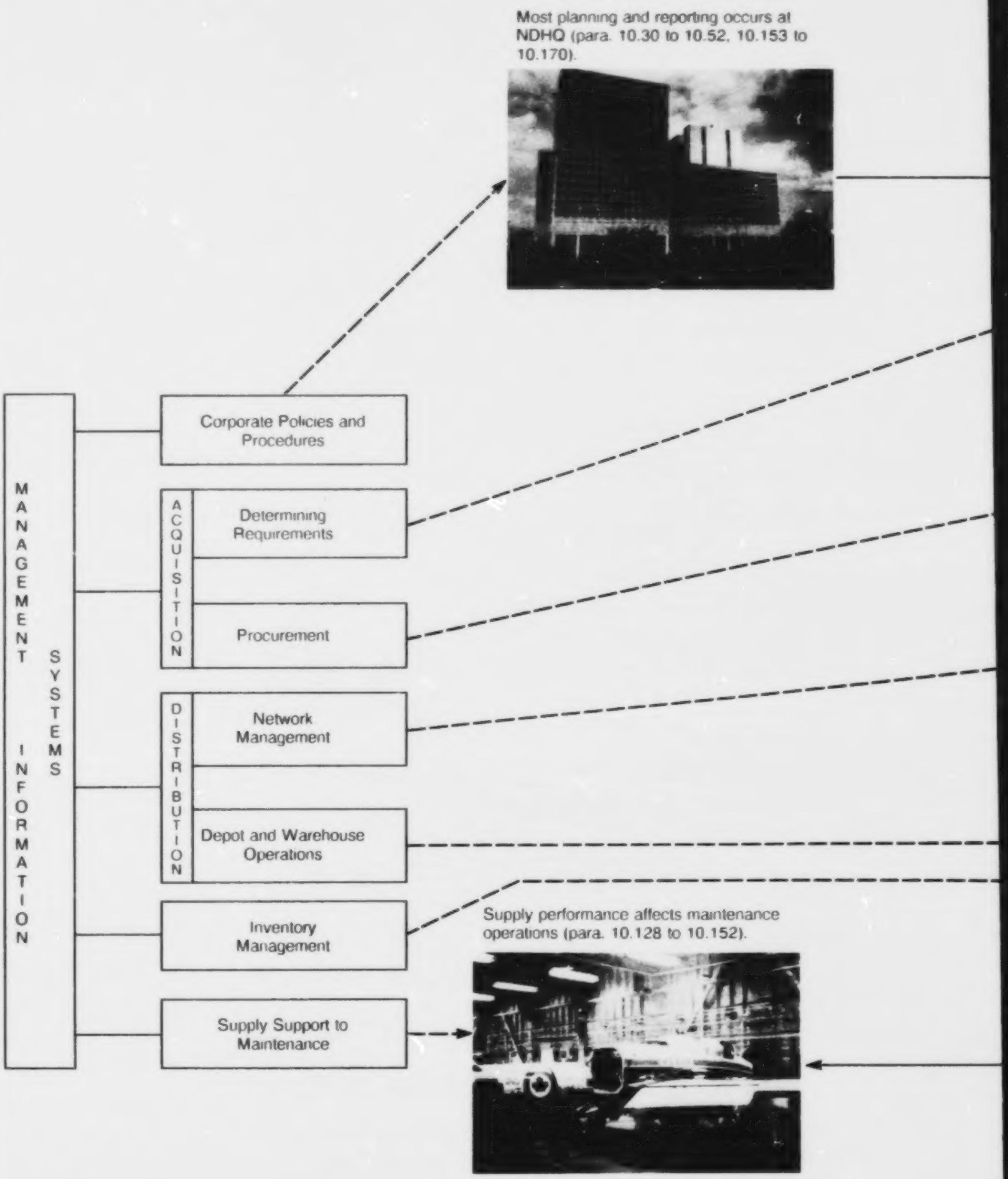
Audit Scope

10.11 Our audit addressed six major areas of the materiel support function in DND:

- materiel support framework, procedures and systems;
- acquisition procedures and activities;
- distribution network operations;
- inventory management, including identification of excess inventory holdings;
- supply support to maintenance; and
- management information and feedback.

10.12 The size and complexity of materiel support in DND did not permit detailed audits of every one of its major operations. Areas such as transportation, combat supplies, repair and

AUDIT SCOPE AND CHAPTER LAYOUT

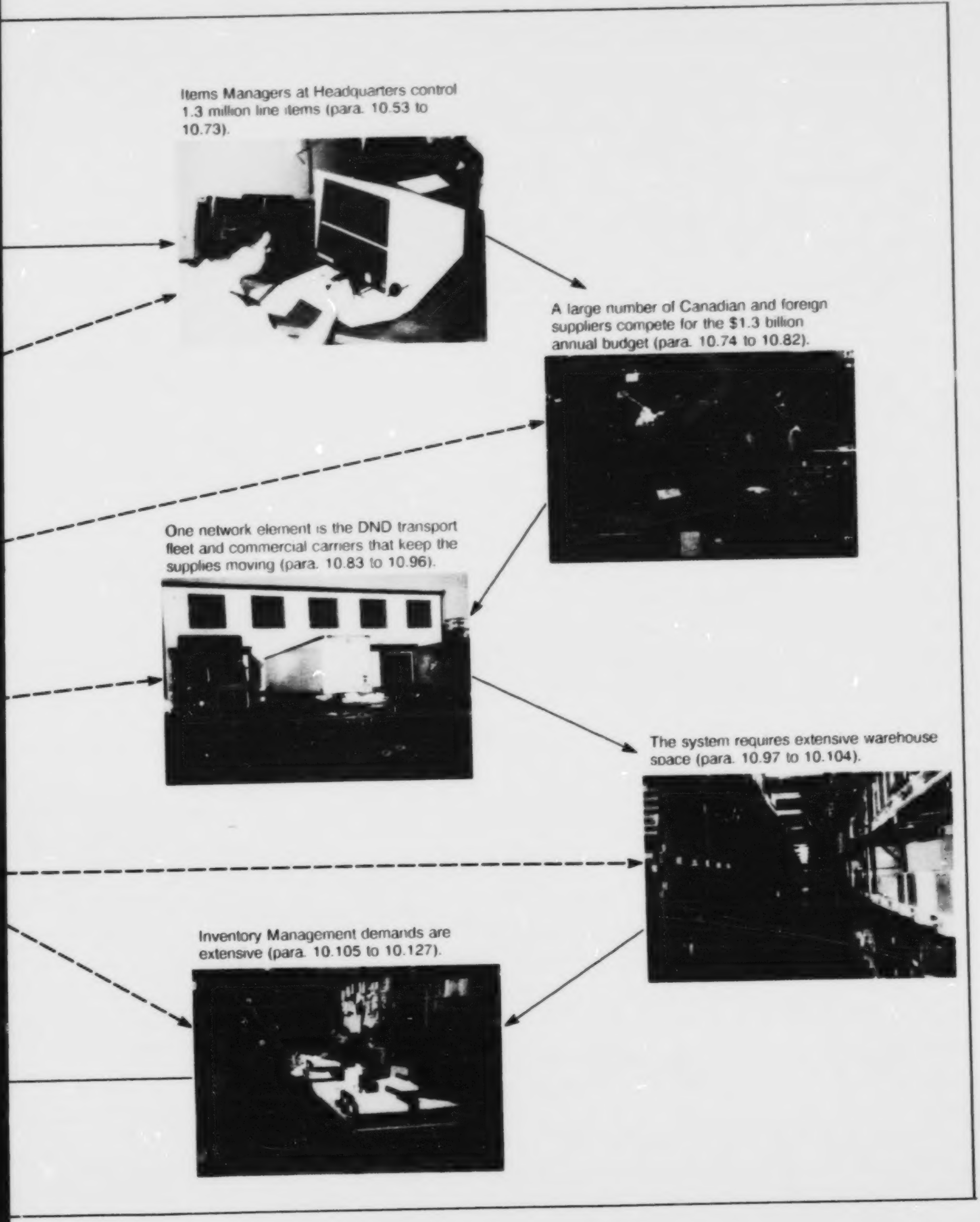


Most planning and reporting occurs at NDHQ (para. 10.30 to 10.52, 10.153 to 10.170).

Supply performance affects maintenance operations (para. 10.128 to 10.152).

MANAGEMENT INFORMATION SYSTEMS
Corporate Policies and Procedures
ACQUISITION
Determining Requirements
Procurement
DISTRIBUTION
Network Management
Depot and Warehouse Operations
Inventory Management
Supply Support to Maintenance

Exhibit 10.1



Items Managers at Headquarters control 1.3 million line items (para. 10.53 to 10.73).

A large number of Canadian and foreign suppliers compete for the $1.3 billion annual budget (para. 10.74 to 10.82).

One network element is the DND transport fleet and commercial carriers that keep the supplies moving (para. 10.83 to 10.96).

The system requires extensive warehouse space (para. 10.97 to 10.104).

Inventory Management demands are extensive (para. 10.105 to 10.127).

overhaul, and quality assurance each involve expenditure levels that, in many cases, exceed the expenditures of some government departments. We intend to review many of these other areas in subsequent audits.

10.13 Although we focused our detailed testing on the supply system, we reviewed the entire spectrum of materiel support management activities and systems above the level of day-to-day operations. Exhibit 10.1 shows the areas reviewed in our audit and indicates where they are discussed in this chapter. In reporting on materiel support we have deliberately chosen to concentrate on the main points to be made. We have opted, in most cases, to not write up a series of individual examples.

General Assessment

10.14 During our audit, we looked at the entire function of materiel support, including the linkages to operations, the overall logistics framework within which it must function, and the force structure it must support. We also reviewed individual components of materiel support at the level of current operations.

10.15 DND is different from other departments in that its ability is fully tested only during wartime. The Department has the responsibility for developing a military force capable of fighting successfully. This capability of fighting successfully is an essential ingredient in contributing to a credible deterrence during peacetime and is the prime objective of the forces in war. Therefore, in addition to other criteria, we adopted the Department's own yardstick, "Will it work in conflict?", as a prime criterion for our audit.

10.16 One important implication of our adopting this criterion was a tacit acceptance that DND support systems and structures must be designed to be efficient and effective under even the worst-case wartime situation. This implies that there will be some unused, reserve capacity that may not be fully used during the much reduced and less complex operations of the support system in peacetime. We took this fact into consideration during our audit.

10.17 During the early seventies, the Department placed less emphasis on the requirement to sustain effective military operations. As a result, concepts of operation, doctrine and force structure related to this requirement slowly eroded. Major support systems implemented during this period, such as the Canadian Forces Supply System, were designed primarily against peacetime requirements

10.18 Recently, and in particular during the course of the audit, the Department has initiated several important projects designed to improve the overall capability of the support system. Some of these projects are discussed in more detail in later sections.

10.19 As a result of our audit, we concluded that neither the materiel support system nor the logistics framework is now suitably developed for sustained conflict. For many of the same reasons, the supply system exhibits significant economy and efficiency difficulties in peacetime.

Observations and Recommendations

10.20 At the level of the overall design and operation of support systems, we found several major problem areas that appear to be at the root of the current state of affairs. The observations in this report at the level of day-to-day operations form part of the cause-and-effect chain directly linked to these major problem areas. They also illustrate the impact on the entire system of materiel support and, by extension, the likely impact on the capability of our forces to fight successfully in war.

Background

10.21 The current materiel support situation did not arise suddenly. The decisions taken by the Department over the past decade or two need to be viewed in the context of policy, force structure development and the effects of unification and integration.

10.22 **Policy**. In the early days of the Alliance, NATO strategy relied to a considerable degree on the nuclear superiority of the United States. Although the importance of conventional warfare was always recognized, the growing nuclear capability of the Soviet Union led in 1967 to NATO adopting the Strategy of Flexible Response, with the full approval of Canada. This strategy called for sufficient, sustainable, conventional capability to defend NATO territory for as long as may be required without the necessity of an early recourse to nuclear weapons.

10.23 During the same period, the late 1960s, the Canadian military was in the middle of unification, an initiative that included a drive to centralize and unify military systems wherever possible as part of a major effort to achieve economies and enhance efficiency.

10.24 For most of the 15 years following unification, the Canadian Armed Forces struggled with these two imperatives – the Department's decisions to economize through centralizing and unifying major systems, and the need to retain a military force with the full capability to conduct sustainable operations, for example within the Strategy of Flexible Response. This dilemma has not yet been fully resolved. Several initiatives in the Department over the past few years indicate a change in emphasis – the need to design sustainable military support systems and structures with the capability of functioning in combat for as long as any government may deem necessary appears to be increasingly stressed in the Department.

10.25 Other initiatives that have an impact on logistics and that indicate a major change in emphasis include the Reserve Force Development Study, the Industrial Preparedness Task Force, the Readiness and Sustainability policy, the Allied Command Europe Logistics and Medical Support Project, Reserve Modernization Projects and other projects arising from the emphasis on sustainability in the recently announced White Paper on Defence.

10.26 **Force structure development.** We recommended in 1984 that:

> DND should design and present to Cabinet a peacetime force structure for the longer term, with an appropriate link to wartime requirements, which can be used as a basis for shorter term decisions within the Policy and Expenditure management process ... It should be consistent with defence policy and fiscal guidance and should include a comprehensive and clearly defined peacetime establishment of personnel and equipment, a proposed wartime establishment and a mobilization plan.

A well defined, longer-term force structure for the Canadian Forces is essential to replace the explicit and implicit structures of the army, navy and air force that disappeared in the aftermath of the unification decision. The Department is still dealing with this complex problem; however, recent initiatives such as the proposed creation of new organizations with responsibilities for force development and materiel doctrine, and the force structure planning work done to support the recently issued White Paper on Defence, appear to be positive steps in accordance with our recommendations in 1984.

10.27 Nevertheless, much of the work to produce a stable force structure for the longer term has yet to be done. The existing system of materiel support is a product of that earlier period when force structure development was lacking or inadequate. And the current materiel support situation in DND reflects that situation.

10.28 **The effects of unification and integration.** As we reported in 1984, DND continues to respond to the effects of the decision to unify the army, navy and air force, and the subsequent decision to integrate the military and civilian components of the Department. These decisions and the pressure to contain the defence budget ushered in a decade or more of unparallelled change. The process of adjustment is still not complete.

10.29 These two decisions also had a tremendous impact on traditional military command and control arrangements. Today, DND is unique among departments of defence in that military and civilian members are blended together into one department under the direction of dual chief executive officers, one military and one civilian. The chain of command can appear complex and difficult to comprehend, to insiders and outsiders alike. The management system, unlike traditional military organizations, relies on shared accountability, matrix management and extensive use of committees.

Materiel Support Framework, Procedures and Systems

> The current logistic framework and materiel support system are not suitably developed for sustained conflict and exhibit significant efficiency and economy difficulties in peacetime.

10.30 In the past 20 years, materiel support for the Canadian Forces has developed in three distinct phases. During the first phase, prior to unification and integration, support was decentralized to the three services and was an integral element of operational formations. Operational Commanders had control over support commensurate with their operational responsibilities.

10.31 During the second phase, beginning in about 1969, materiel support became highly centralized in National Defence Headquarters. Over time, the emphasis shifted from the support of combat operations to increasing the efficiency of support under peacetime conditions. During this second phase, much of the doctrine and the systems infrastructure essential for wartime support operations began to disappear.

10.32 In the third phase, during the 1980s, there has been a renewed emphasis on sustainable combat capability and the need to have systems, policies and procedures adequate for augmenting and sustaining the fighting forces. Throughout this audit we noticed that officials at all levels in DND are beginning to promote the adoption of system, practices and doctrine to ensure a sustainable Canadian force. The following sections of this chapter contain observations and recommendations that we believe would provide a useful contribution to this effort, either by promoting greater economy and efficiency in the use of constrained resources, or by highlighting areas where additional planning might facilitate the transition from peace to war.

Materiel Support Structure

10.33 As a direct result of the policies, procedures and systems implemented during the 1970s, the materiel support system suffers from a number of fundamental shortcomings. These affect both the capacity to support the forces during combat and the efficiency of the system in peacetime. These problem areas are all related in such a way as to present a series of cause and effect relationships that resulted in the current structure for the materiel support system. A discussion of these relationships follows. It precedes our observations at the level of day-to-day operations.

10.34 During the 1970s, or the second phase as we've chosen to call it, it was argued that considerable improvements in efficiency could be achieved by unifying the support systems of the army, navy and air force. As a result, decisions were taken to combine the support services of the forces and to centralize them under the control of civilian officials at National Defence Headquarters. The drive to economize had an impact on the degree to which the new materiel support system was tailored to meet the needs of the Canadian Forces, needs that were in a state of flux at the time. The unique requirements of the three services were largely ignored in the design of the unified supply system.

10.35 Today in DND, there is a growing awareness that these circumstances led to a high degree of centralization and an erosion of support doctrine, as well as the implementation of systems that lack the flexibility for field support operations. It is also becoming apparent that centralization, particularly when it is coupled with a focus on peacetime efficiency and a de-emphasis of the unique characteristics of the three environments, can result in complex systems which are difficult to manage and which cannot always respond to the needs of the users.

10.36 We did not audit command and control directly, but we did note that the thrust to unify and centralize the Canadian Forces resulted in a functionally oriented organizational structure. The National Headquarters organization consists of four Assistant Deputy Ministers, three of whom are responsible for the separate support functions of personnel, materiel support and finance (the fourth is responsible for policy). There is also one Deputy Chief of the Defence Staff who is responsible for operations, and a Vice Chief of Defence Staff who acts as the National Headquarters Chief of Staff.

10.37 The main features of this structure are a shift in the control of support operations from the operational commanders to National Headquarters and the development of strong vertical, relatively independent, support functions which extend from Headquarters almost to the first line fighting units. These support systems tend to bypass the operational commanders who no longer have direct control over support operations within their areas of responsibility or over the design of these systems. Their influence is exerted through the various committees that operate at Headquarters, such as the Defence Management Committee and the Armed Forces Council.

10.38 With the recent emphasis on the need for support policies, procedures and systems capable of providing sustainable support to field operations, it is now apparent that this degree of centralization is not practical. Headquarters personnel cannot span three or four echelons of support and control events on a battlefield thousands of kilometers away. At some point in the support pipeline, strategic support ends and the responsibilities of operational commanders to control support operations must begin. We found that this transition point has not been clearly identified in DND.

10.39 This series of events has several important effects. The polarization of support functions in National Headquarters has inhibited the integration of logistics sub-systems and the integration of logistics with operations throughout the chain of command. The Department has adopted highly centralized support systems which have been largely designed to meet peacetime objectives.

10.40 The failure to delegate control over support operations to commanders commensurate with their operational responsibilities has led to a decline in combat support capability and doctrine. This erosion is reflected in the results of operational exercises, designed to simulate combat. These exercises have highlighted the deficiencies in the support systems in meeting requirements projected for conflict. It is also evident in the difficulties the Department is experiencing in developing and implementing a support infrastructure in the area of combat service support as well as in the difficulties associated with defining materiel authorization and scales.

10.41 A materiel authorization is a formal entitlement to draw materiel from the supply system to hold or to use. These materiel authorizations are scaled (the amount of the item that can be held is calculated) against peacetime and wartime requirements. DND has experienced difficulties in establishing authorizations and scales of issue for warstocks of materiel at various levels in the support pipeline.

10.42 Several initiatives are under way in DND that address some part of these concerns, including major organizational changes at National Headquarters to highlight force structure and operational and support doctrine development, and an allocation of some $200 million for combat service support infrastructure.

10.43 The Department of National Defence should clearly define responsibility for materiel support throughout the chain of command to ensure a complete, sustainable logistics capability for conflict.

> ***Department's response**: Within the established logistics system a highly developed chain of command exists. Operational Commanders have full control over assigned materiel support assets. As members of the Armed Forces Council and the Defence Management Committee they are involved in all major decisions, affecting their Commands including areas of doctrine, training, and logistics support. Existing doctrine and concept of support operations are undergoing a major review in relation to the recent White Paper on defence.*

10.44 The Department of National Defence should ensure that structural elements for support operations such as doctrine and concepts of support operations are updated to reflect current requirements.

> ***Department's response**: It is the policy of the Department that doctrine and concepts of support operations be updated to reflect current requirements. Planned enhancements to the materiel support system, including in the CFSS Upgrade Project, are based upon the "Supply concept Paper - An Operational Framework for the Canadian Supply System - 1990's" which reflects the materiel support requirement of the land, air and sea elements. The CFSS Upgrade is a major element of the materiel support system and will greatly enhance the Department's ability to react to changes in support operations structure.*

Effect on Materiel Support System Development

10.45 To a large extent, the supply system exemplifies the monolithic design resulting from the structural problems discussed earlier. The computer system was conceived and designed in the 1960s. It is now difficult, and in a sense risky, to change the system, because the many changes made in the past have caused a situation where the effects of proposed alterations are hard to predict. The system was designed to be managed totally from Headquarters using historical usage data and complex mathematical models to determine what should be purchased, when it should be purchased and how much should be distributed to each base and depot. It was assumed that this system of automatic computations would require minimum human intervention or management.

10.46 It is now apparent that upwards of 50 per cent of all provisioning actions cannot be handled automatically by the computer; few personnel in National Defence Headquarters have any real understanding of the interactions of the mathematical models in their current state of development; and the high degree of centralization and automation makes the system extremely vulnerable to data inaccuracies. It is also apparent that a system that relies heavily on historical usage rates to determine future requirements is inappropriate for military operations. Support requirements in war would depend more on planned activities than on the historical demand of the previous year.

10.47 The method of operation of the Canadian Forces Supply System limits its ability to support field operations. The system lacks the flexibility to handle the multi-level structure required for logistics support in conflict. The current operation bypasses the commands, and does not provide the visibility of materiel required by commanders to carry out their support responsibilities; for example, the number of spare parts in support of operational equipment.

10.48 Many of the support systems in DND are being improved, and probably the largest of these initiatives is a project to upgrade the Canadian Forces Supply System. As part of the early stages of the upgrade project, DND prepared a Supply Concept Paper that provides a detailed analysis of current system deficiencies and outlines a set of characteristics to be met by any new system. Senior management approved the Supply Concept Paper in 1984. We support the upgrade initiative, but are concerned that the current timetable may be overly optimistic in the light of recent milestone slippage.

10.49 The materiel support needs of the land, sea and air elements of the Canadian Forces will place different demands on the supply system. Although, the managers of the upgrade project received input from commanders on their requirements, as they perceived them at that time, we are concerned that until further work is done to define command and control relationships and materiel support doctrine, it will not be possible to define supply requirements clearly. If the supply system is upgraded without sufficient corporate direction and operational guidance to ensure that the resulting system will meet operational requirements, it may turn out, as it did with the current system, that technology ends up determining doctrine, rather than doctrine determining technology, as should be the case.

10.50 In addition, the commitment of resources increases dramatically as each phase of system development is undertaken. Without the requisite up-front planning and direction, there could be a need for significant redesign to meet requirements, possibly resulting in untimely implementation and increased cost.

10.51 **The Canadian Forces Supply System upgrade project should be expedited and developed in accordance with the criteria recently approved for it. It should incorporate the characteristics described in the Supply Concept Paper accepted by the Department of National Defence.**

> **Department's response**: *The Department has recognized the importance and priority of an Upgraded CFSS which is being developed and progressing as expeditiously as possible. It is being designed to support our operational forces in wartime and peacetime and will incorporate the latest concepts of ADP technology and Materiel Management Methodology.*

10.52 **The Department of National Defence should ensure that planned enhancements and upgrades to the materiel support system are based on the longer-term force structure plan and approved doctrine and concepts of operations and that the system is designed to sustain the forces in combat.**

Department's response: *The planned enhancements to the materiel support system included in the CFSS Upgrade Project are based upon the "Supply Concept Paper - An Operational Framework for the Canadian Support System - 1990's" which reflects the materiel support requirement of the land, air and sea elements. It has the full awareness and support of Defence Management Committee as well as the Environmental Commanders of the Functional Commands. Operational representatives on the Senior Review Board ensure that the Project Office is aware of, and reacts to, changes in operational doctrine that have materiel support implications. When implemented it will provide the Department with the means of achieving total logistic planning including management visibility and responsiveness at all operational support levels.*

Acquisition

10.53 The Department spends over $1.3 billion annually to replenish and repair the items in its inventory. The items range from food, fuel, clothing and other supplies to ammunition and repair parts needed by the Canadian Forces in Canada and abroad to carry out their missions.

10.54 The Canadian Forces Supply System was designed as a centralized inventory management system that was to operate with a minimum of manual intervention. For a variety of reasons, including difficulties with data accuracy, a high degree of intervention is now required.

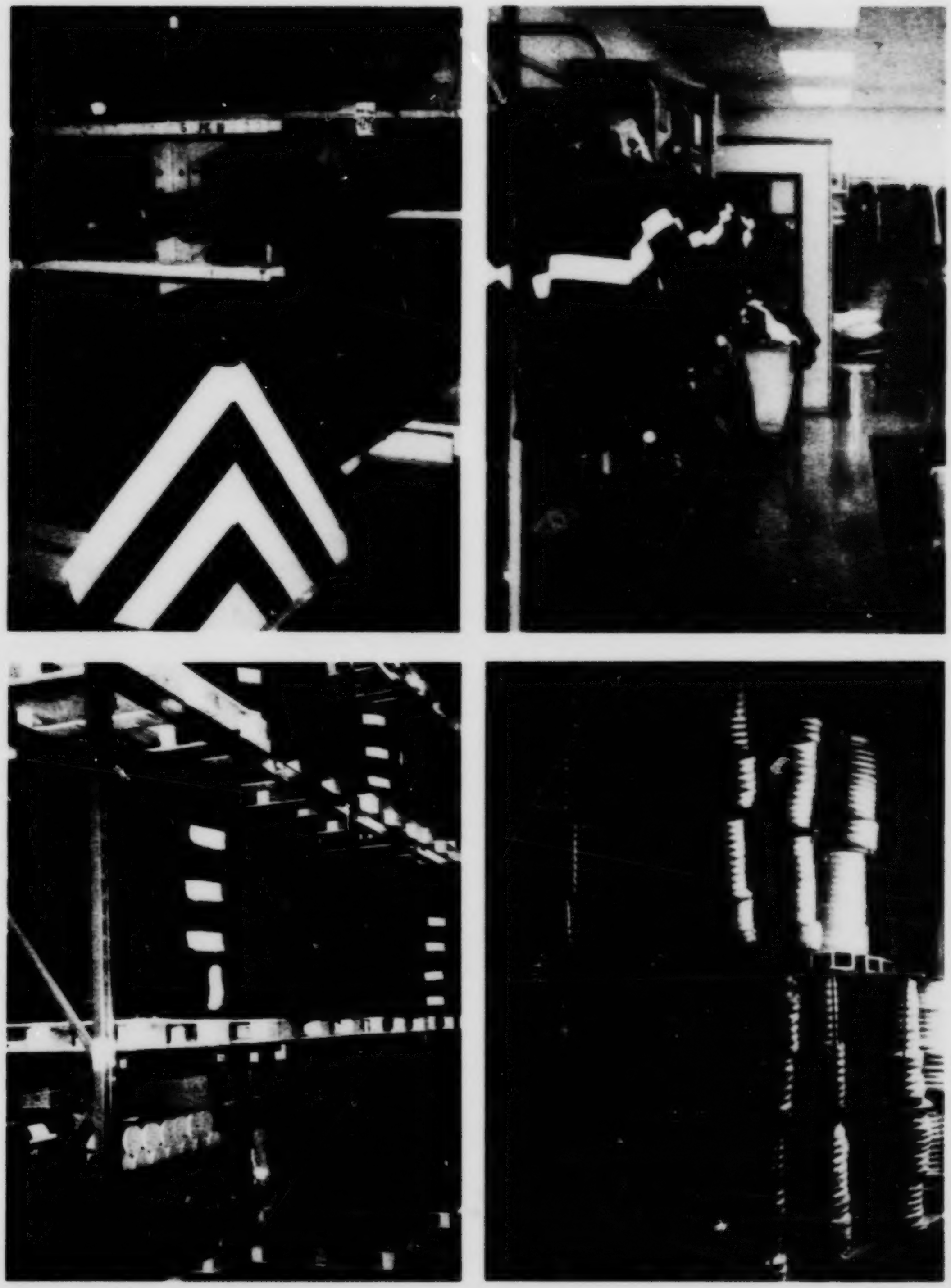
10.55 When total holdings of any given item drop below a re-order level, a computer-generated "buy" instruction is reviewed by one of the supply managers responsible for inventory control. These supply managers validate requirements, initiate demands for acquisition, initiate repair action for repairable items, and ensure proper management of the inventory.

Determining Acquisition Requirements

> For a variety of reasons, including inadequacies in the Canadian Forces Supply System design, inaccurate data, inadequate training and lack of review, the Department at times ends up purchasing supplies earlier than needed to meet current operational requirements. This in turn results in additional carrying costs.

10.56 Of all the inventory management responsibilities of the supply managers, the Department considers the requirements determination process to be the most critical. The accuracy and reliability of inventory information contained in the Canadian Forces Supply System computer records, the training and skills of the supply managers, and the quality of management control are all critical to effective and efficient supply management operations.

10.57 To test the buying decisions, we selected a random sample from items purchased over the last two years that have either a high cost (greater than $500 each) or a high annual



DND maintains inventories that include a diverse range of repair parts and consumable supplies needed to support the Department's people, equipment and weapons systems (see paragraph 10.53).

usage (greater than $20,000 annually). We then tested the purchase quantities that were determined and the timing of the purchases against those that would have been generated if all the data has been accurate and if decisions had been in line with the objectives of the Canadian Forces Supply System. A significant number of the items in our sample were not in line with the supply system purchasing objectives.

10.58 We estimated that, out of the total budget of $1.3 billion, about $35 million worth of goods were purchased in advance of that needed to meet the Department's current operational requirements. Although these goods will be used eventually, the additional costs to DND of carrying these items in inventory is about $7 million a year.

10.59 **Data accuracy**. The Canadian Forces Supply System relies on automated reprovisioning programs that use data such as unit cost and lead time to determine the amount to buy and the frequency of purchasing. If this data are inaccurate, the supply system will request inappropriate buys that can result either in excesses or shortages. Even an upgraded computer system would have to rely on the integrity and accuracy of its inventory data, which, in this case, would be taken from the existing system. We believe, therefore, that existing data inaccuracies should be addressed promptly.

10.60 **Manual adjustments**. Over 50 per cent of computer-recommended buys are manually adjusted by the supply managers. The need to perform manual calculations varies depending on the characteristics of the items (whether it is a high value repairable or a low value consumable), the types of supply problems that the managers may have encountered in the past, and the degree of input from maintenance or operational staff. Indeed, a certain amount of manual intervention is necessary and desirable in any automated system, but this intervention must be based on a full understanding of the impact on total system costs. In DND's case, the very high level of manual intervention makes inventory management sensitive to the skills and training of the supply managers.

10.61 **Training requirements**. Many of the supply managers were unaware of the major factors that influence the computation of buying requirements, or were not familiar with basic inventory management concepts. Because of factors such as the unreliability of data in the system, the supply managers now play a more critical role in determining inventory requirements than was originally intended. Our concern is that supply managers may be required to accept levels of responsibility not envisaged by the qualifications called for in their positions. The Department has acknowledged the need for more training in inventory management theory and practice at all levels, and a new training program is being initiated for all supply managers and supervisors. This is particularly important for supervisory levels because these are the first levels of quality control over requirements determination.

10.62 **Monitoring and review.** Most of the items in our sample were authorized, even though the cost of some items had doubled compared to recent procurements. In many cases, automated requirements data are destroyed following approval of the contract demand, so there is no audit trail for quality review or subsequent audit of the requirement calculation. Given the significant implications of inaccurate data on buying decisions and inventory levels, we believe that greater emphasis should be placed on regularly reviewing the requirements determination process and the purchase decisions that result.

10.63 For all the reasons previously discussed, the Department at times purchases more than is needed to meet current operational requirements, or accepts materiel in advance of need. In most of the cases we analysed, the factors involved create a very complex management challenge. In one case the amount ordered was for twice the quantity needed, but this was later compensated for by an unexpected doubling of the time required to deliver the product. In another case, 30,000 oxygen canisters were received one year ahead of schedule, but the supply system does not provide supply managers with the ability to readily identify advance deliveries and to withhold payment until the appropriate time. The following detailed examples illustrate the effect of data, procedural, training and review problems.

10.64 **Case 1.** An attitude indicator is a flight instrument used aboard aircraft to indicate vertical and horizontal positioning, bank angle and other flight data. A contract demand for the purchase of 16 attitude indicators for the Hercules aircraft was forwarded by DND to the Department of Supply and Services in October 1986 for an estimated value of $340,494. The quantity required was calculated by the automated reprovisioning system and accepted without adjustment by the supply manager who initiated the contract demand.

10.65 Our review of the supporting documentation for this purchase indicates that the automated requirement calculation was incorrect because it was based on invalid inventory data. Because the supply manager did not recalculate the requirement based on more up-to-date information relating to the item's repair lead time, its re-order level and its maximum stock level, the requirement was overstated by six, resulting in a premature expenditure of $127,685.

10.66 **Case 2.** A cooling turbine is a component of the refrigeration unit for aircraft cabin air conditioning systems. A contract demand for the procurement of 15 of these items for the Hercules aircraft was issued in January 1986 for a total cost of $268,954.50. The required quantity was calculated manually by the supply manager.

10.67 Our review of the supporting documentation for this acquisition indicates that a requirement for four of these items had initially been calculated and a requisition was issued for procurement from the U.S. Department of Defense under the Co-operative Logistics arrangement. Because the value of the procurement exceeded $5,000 (see the next section under "Purchase Costs" for a discussion of this area), the supply manager was instructed to cancel the requisition and to issue a contract demand for procurement from a Canadian supplier. There was no explanation on file to indicate the reason for increasing the requirement from 4 to 15 items. We concluded that the manual calculation was based on invalid data relating to the repair lead time for this item. If the correct repair lead time had been used, a requirement for four would have been adequate and the procurement could have been reduced by $197,233.30.

10.68 **Case 3.** A horizontal situation indicator is an aircraft flight instrument. A requirement for two indicators for the Falcon aircraft was calculated by the automated reprovisioning system in March 1985 and the supply manager issued a contract demand to purchase this quantity for a total cost of $45,378.58.

10.69 Our review of the supporting documents for this purchase indicates that the automated requirement calculation was incorrect because the computer system did not reflect the correct stock balance for this item. In March 1985, when the automated reprovisioning system calculated the requirement for two items, a stock balance of one was being reported by the computer. Although only two items were purchased, the computer file for this item subsequently showed a stock balance of 12 items in July 1986. The purchase of these two items was therefore not necessary. We concluded that invalid inventory data, inadequate manual review of computer-generated buy requirements and lack of consultation with the life cycle materiel manager were the major causes of this premature purchase.

10.70 **Case 4**. Nylon utility sheets are high usage consumable items with a unit cost of $37.40. DND purchases the material required to make this item and provides it to contractors who manufacture the sheet according to DND's specifications. In March 1986, a contract demand for 15,000 sheets was initiated with an estimated cost of approximately $300,000.

10.71 The requirement was based on a manual calculation by the supply manager. The automated system had not yet identified a need to reprovision this item. In March 1986, stock records indicated there were 15,114 sheets on hand which was slightly less than the maximum stock level for this item. The computer also showed a forecast annual usage of approximately 9,000 sheets and a procurement lead time of approximately 14 months. We estimate that the order was placed eight months early given the usage and reorder pattern. A shorter order cycle using the same procurement lead time would have resulted in a lower average inventory, and thus a lower carrying cost, being maintained.

10.72 The Canadian Forces Supply System automated reprovisioning system was designed to manage this type of high usage item based on the economic order quantity concept of inventory management. But because of lack of confidence in the supply system's automated reprovisioning system, the supply manager for this item prefers to maintain a manual inventory record and to calculate requirements manually.

10.73 **The Department of National Defence should improve the acquisition process by ensuring that data in the Canadian Forces Supply System are accurate, by providing more thorough training of supply managers and by carrying out a more effective review of acquisition decisions.**

> ***Department's response****: Improvements to the acquisition process dealing with the Operations and Maintenance budget will be achieved through training. This area of concern was recognized by DND in 1985 which led to an independent study of the situation. Consequently, new training courses for supply managers and supervisors at all levels were developed and successfully trialed in 1986. They have been in place as part of a compulsory ongoing training program since February of 1987.*
>
> *Also as a result of the 1985 study, a career development plan for supply managers has been developed and will be put in place with the objective of attaining better qualified personnel for employment as supply managers and supervisors. This will lead to a more professional, better trained supply manager*

> *who will be better prepared to make acquisition decisions and to maintain the accuracy of data on file. It will also lead to more effective management review.*
>
> *The Department has for quite some time acknowledged that limited resource availability has resulted in insufficient personnel being assigned to this activity. The Department intends to continue to address this resource shortfall as departmental priorities and availability of resources permit.*

Purchase Costs

> In an attempt to support "buy-Canadian" objectives, purchases have been directed to Canadian firms rather than through co-operative buying arrangements with the United States Department of Defense. These Canadian firms often end up providing foreign manufactured goods at much higher prices.

10.74 In our sample chosen to test buying decisions, several items raised some concerns. Although the products were available through purchasing agreements first established with the U.S. Department of Defense in 1965, these foreign-made items were actually bought from Canadian suppliers at much higher prices.

10.75 Based on our analysis, we estimate that DND incurred premiums of about $26 million in 1986-87 to purchase mainly foreign-made spare parts from Canadian suppliers. Although previously bought under the agreement at much lower prices, some items were purchased from Canadian agents to meet urgent requirements. In these cases, DND paid higher prices to get the parts as quickly as possible. We estimate the premiums for these types of items to have been approximately $16 million in 1986-87. The remaining $10 million represents premiums paid or committed for items that were not urgently needed and that were acquired by the Department of Supply and Services in response to contract demands raised by National Defence.

10.76 We were informed that the major reason behind the decision to buy the items without urgent requirements from Canadian suppliers was the need to contribute to the Government's objective of promoting industrial development and increasing employment. In most of the cases we reviewed, however, the Canadian content of the items procured from Canadian suppliers was low. It appears that rather than enhancing Canada's defence production, these items had been manufactured outside Canada and the only Canadian content consisted of the handling fees of the intermediaries. Officials of the Department of Supply and Services indicated that they have recognized for several years the need to ensure the greatest possible value to Canada from these transactions, for example, in the area of warranties and after sales service. They are continuing their efforts to reduce the number of instances where little benefit is obtained.

10.77 **Co-operative logistics.** The United States Department of Defense offers an arrangement - referred to as Co-operative Logistics - whereby defence organizations in other countries can add their requirements to U.S. Department of Defense purchase orders, thereby taking advantage of economy of scale and quality assurance arrangements. Several countries, including Canada, have taken advantage of this arrangement, particularly because of the opportunity to reduce costs. The items that can be bought range from weapon systems components to nuts and bolts. This type of co-operative buying arrangement is not unusual. For example, Canada also participates in an arrangement where countries with Leopard Tanks pool their purchase requirements for spares to achieve lower unit prices by buying larger quantities.

10.78 **$5K referral.** To support the buy-Canadian thrust, and in consultation with the Department of Supply and Services, DND issued an internal directive early in 1982, known as the "$5K Referral Program", to limit purchasing through Co-operative Logistics. This directive indicated that any purchase valued at more than $5,000 must be made from a Canadian supplier, if this was economical. However, in practice, the $5K Referral Program was taken as requiring the placement of all orders with a value of over $5,000 with the Department of Supply and Services for procurement from Canadian suppliers, even if such orders could have been placed elsewhere at a much lower cost. It is the responsibility of the Department of Supply and Services to obtain the best value for the required quality. However, the Department's sourcing policy requires that if three Canadian sources exist, the order would normally be placed in Canada, subject to considerations of cost and delivery. In this situation, if the price seems reasonable, DSS does not normally consider foreign sources.

10.79 **Price increases.** DND's inventory records clearly show that significant increases in costs occurred when foreign-made spares eligible for procurement under the Co-operative Logistics agreement were bought from Canadian suppliers. Internal DND correspondence questions the policy of sourcing through these Canadian agents and notes that the Department often ends up paying significantly higher prices for items with little or no Canadian content.

10.80 Exhibit 10.2 is a list of some of these items. The Canadian content shown in the exhibit is that declared by the supplier. The prices of items under the co-operative agreement have been adjusted for exchange rates. For the purpose of our analysis we excluded other possible charges, such as freight, from both prices.

10.81 There are two parallel purchasing processes in operation. The normal process used for most government departments is managed by the Department of Supply and Services. As part of this process, suppliers are classified, with preference given first to Canadian manufacturers, second to Canadian agents of foreign suppliers where the agents have significant repair facilities in Canada, third to Canadian agents of foreign suppliers and fourth to the foreign suppliers themselves. The second process - purchasing under Co-operative Logistics agreements - has been delegated to DND. Communication could be improved between those responsible for the two processes to determine what effect buying from agents of foreign suppliers has on the cost of the items purchased.

10.82 The Department of National Defence and the Department of Supply and Services should revise "buy-Canadian" guidelines and criteria in terms of the premium that National Defence should be prepared to pay to buy from Canadian rather than foreign sources, and in terms of the kind of business activity that should qualify as Canadian value-added. Within these revised guidelines, steps should be taken to ensure that due regard for economy is adequately considered for whatever purchasing approach is taken.

Exhibit 10.2

EXAMPLES OF ITEMS NOT PURCHASED THROUGH CO-OPERATIVE LOGISTICS (in Canadian dollars)

Item	Co-operative Logistics Price	Actual Price Paid	Increase %	% Canadian Content Declared *	Total Order Value
1. Coupling	$ 611.45	$ 2,010.27	228.8	23	$ 60,308.10
2. Electron Tubes	62.50	133.08	112.9	17	49,905.00
3. Strainer Element	713.38	1,143.31	60.3	10	171,496.50
4. Butterfly Valve	912.42	8,613.23	844.0	23	86,132.30
5. Aircraft Turbine	10,492.06	17,930.30	70.8	33	268,954.50

* Declared by supplier

Department's response: *Primary responsibility for obtaining value for money in government contracting for goods and services rests with the Department of Supply and Services. As a client department with responsibility to manage resource allocations, we strongly support this recommendation and will work closely with DSS for the formulation and implementation of appropriate policies and guidelines for this activity.*

DND will begin coding all spares requisitions valued over $5,000 to identify a potential for COLOG acquisition. Additionally, the process will be reviewed to identify means of increasing communications between the responsible officials in the two departments.

Distribution

10.83 Distribution of materiel at National Defence is carried out through a network ranging from the national level depot to the end consumer. This network is managed by a variety of groups, each with responsibility for one or more components. A co-ordinated approach to planning, measuring and controlling distribution is essential for organizations with large networks since a change in one network component will have an effect on the others. The objective is to ensure that changes will result in an overall improvement to operations.

10.84 The wartime and peacetime planning, management and reporting demands of this system are extensive. As we noted earlier, policy and organizational decisions made over the last two decades, combined with fiscal pressures and an out-of-date supply system, have resulted in a number of difficulties for managers in DND. For the distribution system, the results have been the fragmentation of management and reporting and a number of inherent inefficiencies in operation.

Network Management

> Current distribution plans do not reflect an overall strategy encompassing both peace and wartime operations. Information for managing the complex DND distribution network is incomplete.

10.85 The Department has plans to improve several distribution network components, including the development of an upgraded supply system, the development of a new computer system to support transportation, and the expansion of depots and bases. The Supply Branch is responsible for the distribution network from depots to bases. Supply directorates, responsible for various aspects of the network, have been asked to prepare individual "business plans" to be used to develop an overall "business plan" for the Supply Branch. However, long-and short-term integrated plans addressing strategic goals do not exist. The strategy or concept that considers all aspects of distribution together is not well defined. DND has not established a formal strategy development and implementation process.

10.86 **Wartime needs**. One type of strategic issue that needs to be addressed at this level is the capability to meet estimated wartime activity rates. There is a shortage of storage space at many depots, and the Department has noted that it is unlikely that it will be able to expand materiel processing capability to meet the increased activity that would occur in war. Mobilization plans, addressing how to move from a peacetime posture to a wartime posture, are being prepared for depots for the first time.

10.87 **Redistribution.** Redistribution is another example of a network issue. There is a constant, heavy flow of materiel from industry in Canada and other nations through the supply depots to the base supply facilities. Redistribution of stock occurs as a built-in feature of the Canadian Forces Supply System. When an item is needed but not available at a base, the system first searches the depot serving the base, then other bases in the region, then other depots. If the materiel is found in any of these other locations, the computer issues a redistribution order.

10.88 We found that over 492,000 items were issued from depots to bases outside their prescribed region over a 12-month period. This represents 33 per cent of all depot issues. Of this total, 58 per cent of the shipments had a value of $50 or less. We estimate that these out-of-region shipments cost the Department about $12 million a year. In many cases, the redistributions occurred for somewhat mundane items such as small tools, fasteners and office supplies. Although a certain amount of redistribution is to be expected and actually contributes to the flexibility of the system, we have not seen evidence of levels being set and measured and trends being analysed as part of an overall effort to determine when redistribution is inefficient.

Packaged goods awaiting shipment in a supply depot. One-third of all such shipments are to users outside the normal geographical delivery pattern (see paragraph 10.87).

10.89 It may be more practical to buy an item locally than to have it shipped over long distances. DND has a Local Procurement Screening Board that considers submissions to have items decentralized for procurement locally. In arriving at its decisions, the Board uses criteria such as the maximum cost of the item and total annual usage. It does not apply criteria such as total distribution cost. In the past, only Headquarters supply managers recommended items for local procurement. During our audit, however, the depots and commands received instructions to provide suggestions as well. Also, the Department intends to increase the number of items considered for local procurement.

10.90 **Demand satisfaction.** When items are not available over the counter but are required immediately, the demand is classified as an Immediate Operational Requirement (IOR). With an IOR, the demand is expected to be filled within 48 hours. A number of DND studies have revealed abuse of this high priority demand category to expedite system reaction to demands. IOR demands impose extra effort and costs to process and distribute. Some analysis and reporting of the causes of IORs are being done by the procurement group responsible for air equipment. But we found no evidence of any attempt to determine the system-wide cost of satisfying this category of demand.

10.91 **Management information.** Despite the size of the distribution operation at DND, there have been no studies that directly addressed global network issues. Certain global issues have been raised, but only as peripheral points to the main focus of the studies. Inspection style visits are carried out at bases and depots focusing on compliance with procedures and assigned service targets. These visits are useful and often result in improvements, but they are not a substitute for analyses with a global perspective as a means of presenting a complete message to management.

10.92 With the exception of depots, which measure manpower used against transaction volumes, there is no overall measurement of efficiency. Since the visible measures of performance relate to meeting demand, there is an incentive to increase inventories so as to be sure of meeting that demand. Because distribution cost and the cost of holding items in inventory are not monitored, bases may increase their inventories at no cost to themselves.

10.93 The most widely used management information report is the Canadian Forces Supply System Management Information System Summary. It is published monthly and is available about six weeks after the month-end. A two-page comment on the report is prepared from this summary for senior management. This two-page report explains the percentage of change between two months. It does not provide a complete summary of activity, nor does it identify potential problems or areas requiring action. The whole Summary is a useful report, and it provides an indication of effectiveness at the national level. But some figures are either too general or too detailed to provide an adequate overall assessment of the performance of distribution.

10.94 Many groups at National Defence Headquarters manage portions of the supply network (strategic transportation, depots, etc.). However, no one group is responsible for providing strategic direction for the total system. As a result, questions such as the rate of redistribution, IOR satisfaction rate, or the cost of meeting certain fill rate targets are addressed in isolation, not from the perspective of total system management.

10.95 The Department of National Defence should develop a plan, within an overall strategy, to improve the management of the distribution network as an integrated system in peacetime and in war.

> ***Department's response:*** *DND is fully cognizant of the need to improve the management of its distribution network. Over the past few years we have undertaken a number of initiatives. For example, the Depot Modernization Task Force Study, the CFSS Upgrade Project and the National Materiel Distribution System are intended to modernize and improve the management capabilities of our Distribution Network.*
>
> *Although these and other initiatives have not been documented into a single strategic plan, close liaison between the involved staffs is maintained to maximize the integration of the various components. The Department agrees, however, that it may be advantageous to summarize these initiatives into a single report.*

10.96 The Department of National Defence should improve management information on the distribution network to allow for analysis of network-wide issues, such as overall service levels and redistribution versus local purchasing, and to ensure the reporting to senior management of possible problem areas.

> ***Department's response:*** *The Department has recognized the need for improving management information on the distribution network. Some of the improvements must await the introduction of implementation of the CFSS*

Upgrade. However a review of potential enhancements is under way to identify those which can be introduced in a reasonable timeframe. We are also undertaking a review of the total network management information system.

Distribution Operations

Distribution network operations suffer from component inefficiencies that are often caused by an outdated system.

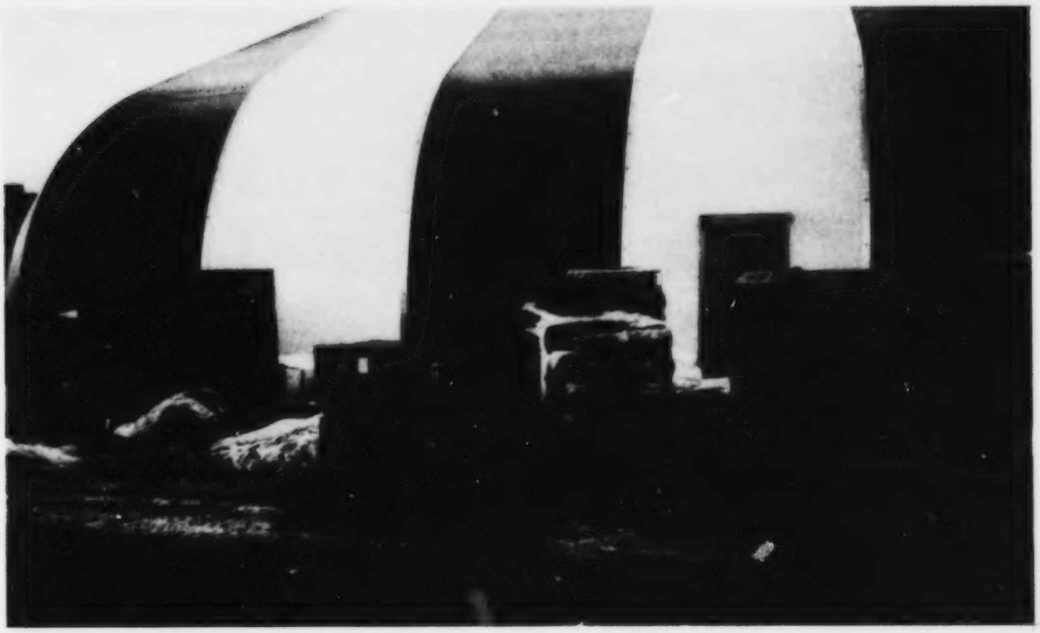
10.97 The departmental satisfaction rate goal of 80 per cent is consistently not achieved across the supply system. This means that in all base and station locations customer demands have not been satisfied up to the 80 per cent performance objective from internal stock holdings or through local purchase. Actual supply system satisfaction rates varied between 72 per cent and 78.5 per cent for 1986. Highest priority demands, like Immediate Operational Requirements, must be satisfied within 48 hours. Average system-wide performance for these demands has been between 12 per cent and 17 per cent, and is an acknowledged management priority for the Department.

10.98 Many of the Department's supply facilities are old and inefficient. In some cases, base supply operations are spread across 10 different buildings which are scattered around the base. In some facilities, heavy stock must be moved by hand in tight quarters. In the supply depot located at Downsview, sensitive materials were being held in an outdated wooden hangar that is scheduled for demolition. In some cases parts that were not appropriately packaged were unusable as a result of being housed in temporary shelters without climate control. The Department has begun a Depot Modernization Program to address these concerns.

10.99 Also, although the system is operational for 16 hours a day, base officials often have limited access to the Canadian Forces Supply System for data entry or analysis purposes, either because there are not enough terminals or because of time zone constraints.

10.100 Despite all this, officials in these organizations are constantly seeking ways of providing better service. This is shown by the fact that, on balance, supply officials do a reasonable job of satisfying peacetime supply demands. However, the system itself imposes delays and inefficiencies. At times, staff in various locations assign inflated priorities to requisitions in an attempt to force the system to react more quickly.

10.101 **Materiel receipt.** The filling of outstanding requisitions for goods in bases and depots is hampered by the system. Except for IORs on the bases, there is no procedure whereby materiel for which there are outstanding requisitions is recognized when first received. In these cases, the materiel must be put away and computer records must be updated before the outstanding requisitions can be filled. Only then is the materiel picked and shipped. This results in a three-to-four-day delay and leads to extra work in handling materiel.



In many locations large shelters are used to protect stock from rain and snow. These shelters are not climate controlled (see paragraph 10.98).

10.102 **Paperwork burden.** Approximately 400,000 "hasteners" are printed each year at depots, 700,000 in Headquarters, and another 1.8 million at bases and stations. Hasteners identify situations where an expected action has not taken place within a certain time. If the situation causing a hastener is not resolved, further hasteners are automatically printed at pre-specified time intervals. The basic purpose of a hastener is sound, but at certain bases, depots and at Headquarters we found that the first two or three hasteners for non-priority demands are printed, distributed and then not acted on. One reason for this is a lack of time to review them. Another reason is the expectation that most of them are caused by paperwork delays and that they will disappear without any special action. The impact is that a minimum of 900,000 hasteners a year are needlessly overloading the system. Analyses of the hasteners show that most do indeed occur because of paperwork problems, and not because of transportation delays or a lack of materiel. The Department has recognized the problem associated with hasteners since the implementation of the Canadian Forces Supply System. DND officials indicated that this design deficiency would be addressed through the enhanced capabilities of the CFSS Upgrade.

10.103 **Record accuracy.** At some bases, there were delays of 1 to 35 days in entering data into the computer with most delays averaging 15 days for non-priority demands. The longest delays were related to staff illness and to peak work periods - for example, when there are operational exercises. Input delays, as well as paperwork problems, often result in inaccurate records on the computer system. The computer initiates actions for satisfying new demands, redistributing materiel and purchasing based on the status of the data on record at that time. When the data is not up to date, the computer will initiate actions that may be inefficient or uneconomic.

10.104 Studies in these areas would likely lead to efficiency gains, but much of the difficulty seems to be related to the current system design. Real improvement would depend on redesigning the support system.

Inventory Management

10.105 The Materiel Group is responsible for providing materiel support to the Canadian Forces. After the requirements have been determined and materiel has been procured, supplies are held in the distribution system until issued to the final user. Supplies remain in the hands of the users until they are consumed or become unusable or obsolete. Repairable items are repaired and then returned to the distribution system.

10.106 The Supply Branch is responsible for the management of all inventory held at depots and bases. On a day-to-day basis, supply managers are responsible for ensuring that inventory items are acquired, stocked, repaired and issued in a timely manner and in sufficient but not excessive quantities. To do this, supply managers must:

- compile, calculate and maintain information required for procurement and inventory control at the national level;
- maintain inventory holdings at an optimum level;
- initiate repair action for repairable items; and
- perform other inventory management functions including disposal of obsolete stock.

10.107 In previous sections we covered the acquisition and distribution of materiel. Other important inventory management concerns are inventory levels, excess stock and the relative importance of inventory items.

Inventory Levels

> There is little overall management of inventory levels or analysis of the impact these levels have on system performance.

10.108 Maximum stock levels are automatically calculated by the computer system, based on consumption history for both system-wide holdings and base holdings. When quantities reach a re-order level, the usual procedure is to place an order to bring inventory up to the maximum level. Maximum stock levels system-wide can be adjusted by supply managers at Headquarters. Base maximum levels can be manually adjusted by base supply staff.

10.109 Information is available on the management of inventory, but it is analysed on an after-the-fact basis and not necessarily in relation to the potential impact of various

Updating computer-held information is critical to the efficient and effective operation of the supply system. Inaccurate data are often the result of paperwork delays, inefficient materiel handling and input delays (see paragraph 10.103).

decisions on system-wide inventory levels. Because maximum stock levels in the computer have a direct effect on purchasing, distributing and holding inventory, we expected the Department would have evaluated the validity of these levels in terms of past and projected consumption levels at both depots and bases. This is not currently analysed, so we conducted a test ourselves.

10.110 We found large inconsistencies between stock replenishment indicators and consumption, both between bases and between system indicators and the total of all bases. This situation could lead to inventory being held where it is not needed and shortages occurring elsewhere. We determined that there are indications of possible inventory balance problems. Computer formulae that recommend purchase quantities have not been evaluated for accuracy of operation, data errors occur and have significant impact on the results of automatic computations, and purchase calculations ignore available information on future changes in consumption patterns.

10.111 Although indirect measures such as demand satisfaction exist, there are no procedures to measure and evaluate inventory decisions system-wide. Because authorized stock levels are not based on analyses of consumption, inventory can be unbalanced, resulting in higher than necessary levels of inventory at some locations, or in redistribution to meet shortages at other locations.

10.112 The Department of National Defence should evaluate inventory management practices on a system-wide basis to identify weaknesses leading to unbalanced stock levels.

> ***Department's response:*** *Although our current automated system does not provide us with planning and scheduling data, this capability has been incorporated into the CFSS Upgrade Project and will give the Department improved inventory management capabilities.*

Excess Stock

There appears to be a large amount of excess stock in DND's inventory.

10.113 The annual carrying costs of DND's inventory, using a conservative estimate of 20 per cent of historical value, is $1.5 billion a year. These costs stem from personnel requirements, facility costs, care of materiel, and the cost of having funds tied up in inventory. This scale of cost warrants the highest possible level of management attention.

10.114 **Identifying excess.** As part of our examination we requested a report of all inventory items that met DND's definition of "excess". Excess status, depending on the nature of the item, is achieved when current holdings equal the maximum stock level plus three or four times the amount that would normally be purchased as an economic order quantity. The Department only began identifying possible excess stock holdings on a systematic basis within the past two years. At the end of 1984, a new feature was added to the Canadian Forces Supply System that enabled the production of a quarterly system excess summary report. Prior to that time there was no regular reporting of possible surplus stocks.

10.115 The Canadian Forces Supply System manages approximately 1.3 million line items valued at over $7.5 billion. Departmental reports indicate that between 10 per cent and 13 per cent of these line items are either inactive or slow moving. The estimated carrying cost of these items is $240 million.

10.116 Although DND implemented the quarterly summary to identify inactive and slow moving items, it has not yet put together an effective process for systematically determining the portion of excess stock that should be disposed of. We believe that significant savings could be achieved if the Department implemented a more effective process for removing surplus inventory on a more timely basis.

10.117 **Stockpiles for emergencies.** There are many reasons for having excess stock. Declining demand for an item over time can result in the computer automatically lowering the maximum stock level and causing the item to appear on the report. Phasing out of certain equipment types and not purging the system of parts for the equipment, or simply buying too much of certain items, can also cause excess. We were advised that some of these excess items are, in fact, stocks that have been set aside for emergencies. The Department specifically identified items valued at $300 million as being kept for emergency use.

10.118 Other items may only temporarily be reported as excess because reprovisioning was carried out in anticipation of major repair programs and the maximum authorized holdings have not been adjusted accordingly. In addition, items may be reported incorrectly because of errors in entering inventory data.

10.119 **Current action.** In 1985, because of an urgent space problem, the Department decided to prepare a list of all line items held at one depot that had had no usage during the previous four-year period. Almost 100,000 line items were identified as meeting this criterion. These items cut across all stock classes administered at the national level. As of January 1987, DND had examined all items and had earmarked over 30,000 for disposal. In addition, lists of potential excess items were sent to other depots while the audit was taking place.

10.120 DND reviewed the excess summary report and identified items with a value of approximately $650 million that exceeded current requirements but were to be retained. This stock will support equipment that is planned to be used for the next 10 to 15 years. Although useful, these excess holdings are incurring carrying costs estimated at $130 million annually and are adding to the current shortage of warehouse space. Of the $7.5 billion total inventory, the true potential surplus is acknowledged by DND to be approximately $300 million.

10.121 We believe that reviews for surplus stock should be a regular part of DND's inventory management practice. This is especially true now that a depot expansion program is being initiated as a result of a lack of available storage space.

10.122 **The Department of National Defence should improve reporting of excess and surplus stock to include carrying costs, identify and change inventory management practices that lead to the accumulation of excess and surplus stock, and systematically dispose of items that are determined to be surplus.**

> ***Department's response:*** *The Department is well aware that due to the significant cost of holding materiel in depots, a mechanism for periodic review and purging of surplus stock is an essential element in the materiel management business. Considerable effort has been spent on projects to review individual depots and to introduce improved reporting and disposal procedures. The Department is reviewing existing inventory management practices to ensure that the build up of the inventory is at a reasonable level. Supply manager training will enhance this effort. Additionally, the ADP capabilities associated with the CFSS upgrade will permit the Department to improve the existing reporting procedures to include cost data. Due to resource constraints, insufficient personnel have been assigned to this activity. The Department intends to continue to address this personnel shortfall as departmental priorities and availability of resources permit. Options to contract out some of this activity are also being considered.*

Relative Importance of Items and Effectiveness Reporting

> The Canadian Forces Supply System treats all items in the same manner. No distinction is made between critical warstocks and peacetime requirements.

10.123 Under wartime conditions, the present supply system's computers would assign equal priority to purchasing paper plates and tank spares. Operational commanders would want to know that critical warstocks were being given special attention and that priority would be assigned to the most critical items.

10.124 The effectiveness of the Canadian Forces Supply System is measured on the basis of the average demand satisfaction rate. For example, if a target average satisfaction rate of 80 per cent is established, the system is viewed as meeting this target if, on average, customers get what they need 80 per cent of the time. The difficulty with this approach, however, is that while demands for paper plates and toothbrushes may be satisfied 100 per cent of the time, demands for critical weapons system components may be satisfied only 60 per cent of the time, or vice versa.

10.125 DND has taken preliminary steps to categorize items used by the land forces in Europe. It uses five measures, ranging from "cosmetic" to "mission critical". Only mission critical items would be carried into the field during wartime; cosmetic items would remain back of the combat zone. This project is still in the preliminary stages.

10.126 An approach that addresses the relative importance of items would also be useful in allocating resources for readiness and sustainability purposes.

10.127 **The Department of National Defence should introduce into current and future inventory management practice an approach that takes into account the relative importance of items.**

> **Department's response**: *In areas of critical operational support, supply management exercises direct involvement and control over major equipments and weapons systems. There is a specific plan to introduce a concept of item categorization into the Upgraded CFSS.*

Supply Support to Maintenance

10.128 A key measure of the effectiveness of the supply system is the extent to which it supports the maintenance requirements of the equipment fleets. We reviewed nine weapon systems: the Sea King helicopter; the Aurora; the Hercules; the Tutor; the CF-5; the CF-18; the M113 armoured personnel carrier; the 2.5 ton truck; and the destroyers. These fleets were chosen because their maintenance costs were the highest in DND at the time of our audit. This review helped us to identify a number of supply-related difficulties that are limiting equipment availability or readiness. Some of these problems arise because there is little integration between supply and maintenance systems and processes; some are unique to supply.

10.129 Wear and tear on operating equipment generates demands for maintenance which in turn creates demand for replacement parts. These are normally supplied from inventory. Some parts, including most of the high value parts, are repairable. So when the old part is taken off the equipment, it is sent to be repaired or reconditioned and then returned to inventory to be used again. This process is referred to as the "repairables pipeline".

10.130 Problems in maintenance or with the supply of replacement parts can cause difficulties in maintaining a fleet of equipment in the required state of operational readiness. DND has a method of attributing the cause of non-serviceable equipment to maintenance or to the supply of parts. In practice, the relationship between maintenance problems and parts supply problems is more complex than the performance information might suggest. Lack of a part causing a piece of equipment to be non-serviceable is defined as "Not Operationally Ready due to Supply" (NORS) for air and "Vehicle off Road (VOR) due to supply" for land equipment. In the case of air, this situation is frequently avoided by "robbing" another aircraft in for servicing. Frequent robbing is acknowledged not to be a good practice because it increases the workload on maintenance, complicates the tracking of part life and, for some parts, increases wear and tear.

The Relationship of Supply Management with Life Cycle Materiel Management

> An integrated materiel support system should bring together system components of supply, maintenance, and transportation. As stated earlier, this has not been achieved and the Canadian Forces Supply System now operates independently of maintenance and transport systems. This means that the quality of inventory decisions depends largely on the extent of communication between supply managers and Life Cycle Materiel Managers.

10.131 Life Cycle Materiel Managers are assigned the responsibility to manage equipment fleets through their life cycles - from planning and acquisition to eventual replacement. In addition, items that have specific engineered specifications are acquired and managed in co-operation with these managers. Life cycle management deals with "system management", a concept that entails looking at a piece of equipment as an intrinsic whole. Supply, on the other hand, operates under an item management concept where each item is considered independently. This basic conceptual difference requires that Life Cycle Materiel Managers and supply managers communicate regularly and be aware of the others' requirements. In fact, in some cases, the supply managers are responsible for an entire weapon system and deal direct with the appropriate life cycle materiel managers.

10.132 **System design limitations.** The system supporting the supply of parts and materiel for maintenance generally is not structured along equipment management lines. We found that for most weapon systems, there is no process using the existing information system to forecast all equipment parts requirements based on planned operating time multiplied by expected usage rates and failure rates. Provisioning for the most part is based on projections from past usage unless the supply manager and the Life Cycle Materiel Manager manually intervene to reflect their knowledge of future activities. Nor can the present system automatically accommodate all forecast requirements based on planned future usage and on known current problems. Adjustments have to be made manually when problems come to the attention of the Life Cycle Materiel Manager or when a modification has to be introduced.

Hercules aircraft are the "workhorses" of the air transport group. As this fleet ages, repair parts become increasingly difficult to obtain (see paragraph 10.134).

Camouflage nets are used to cover military vehicles, equipment and supplies on the ground to avoid enemy detection (see paragraph 10.135).

10.133 The exponential smoothing of historical data would fail to anticipate sufficient future needs in the case of an extremely large step up in demand, for example, to the level expected in war. A forecasting system, based on sound equipment systems management practice and linked to projected operational requirements, would be expected to perform in a superior manner. The Department is examining methods of implementing an equipment system management approach. We support this initiative, although careful consideration of costs and benefits should precede any final decision.

10.134 **Communication is required.** As we indicated under our discussion of Co-operative Logistics, our sample of recent acquisitions for the year 1986-87 indicated that an estimated $16 million of additional costs were incurred to meet immediate operational priorities. These foreign-origin items were available under Co-operative Logistics agreements but were acquired from Canadian agents to obtain shorter lead times. About two-thirds of this estimated amount related to Hercules aircraft parts. In the case of the Hercules, world shortages of certain parts developed as suppliers reduced inventories and cut back production for this older aircraft. When the Canadian Forces Supply System initiated a buy, the parts were not available immediately from the original manufacturers or through the Co-operative Logistics arrangement. So, DND was forced to buy scarce items from Canadian sources at much higher prices. Had the Life Cycle Materiel Manager taken steps to communicate with suppliers to anticipate potential sourcing difficulties, these additional costs might have been avoided.

10.135 There is also a need for communication between supply managers and Life Cycle Materiel Managers. There have been cases where supply managers have initiated procurement action without adequate consultation or despite stated requirements. An example of the latter occurred when the army required camouflage nets with certain detection-resistant features. A buy was initiated for nets that did not meet these unique requirements. As a result, $400,000 worth of nets have been acquired that may be unsuitable. DND recently undertook tests to determine if there was some way these nets could be found acceptable for Canadian Forces use in the future.

10.136 Usually the Life Cycle Materiel Manager deals with more than one supply manager, such as for "common items", and this increases the difficulties. For example, in the case of the Armoured Personnel Carrier (APC), we found co-ordination problems because two items were required for a modification and, therefore, two separate supply managers were involved. An order for an old part for the APC was adjusted to refer to the modified part. However, the modification required a second item which had not been ordered. This caused delays while the old part was reordered and used until the complete modification was available.

10.137 Only the supply manager has direct access to information on the stock levels of maintenance spare parts. Feedback from maintenance personnel in the field about problems with specific parts is generally directed to the Life Cycle Materiel Manager. Close co-operation between these two staffs is therefore essential. The Department recognizes this need and has co-located the two functions in an attempt to improve communications.

10.138 The Department of National Defence should ensure that the Canadian Forces Supply System upgrade project addresses the need for an integration of supply and maintenance planning and the co-ordination of supply and maintenance operations.

> ***Department's response:*** *Agree. This is being addressed by the CFSS Upgrade.*

Repairables Pipeline

> The Department has encountered difficulties in controlling its repairables pipeline. This has contributed to shortages of some replacement parts for certain weapon systems.

10.139 A major proportion of the value of spare parts inventory consists of "repairable" items - parts that can be repaired or reconditioned. When a new repairable part is placed on the equipment, the maintenance personnel are expected to return the used part so that it enters the "repairable pipeline".

10.140 **Pipeline delays**. We found a high proportion of delays in obtaining parts from the repairables pipeline. Particularly there were delays in the cases of the Sea King, Aurora and the Armoured Personnel Carrier. The Department is introducing a new system for monitoring parts while they are in either departmental or contractor repair facilities. This should help to reduce the exceptionally long lead times through those facilities. We found that the contract agreement for a 90-day turnaround time was not being met by numerous contractors and was not always being enforced by DND. This has contributed to a high level of robbing activity for the Sea King and Aurora, thus increasing maintenance time and wear and tear on the parts involved.

10.141 The Department also recently introduced a new system for centrally controlling the return of used parts from maintenance. This system was not working well because of large volumes of incorrect data. Errors in data input were causing parts to be listed as outstanding when, in fact, they had been returned.

10.142 **Managing repairables.** Maintenance managers would normally determine operational and maintenance requirements, prepare production and/or maintenance schedules and convey this information to supply managers to ensure adequate supply support. Highly critical to this function is the forecasting of numbers of repairable parts to be overhauled. Responsibility for computing repair forecasts has been delegated to supply managers, who, in consultation with Life Cycle Materiel Managers, must determine the quantity of an item to be repaired during a forecast period of 24 months. These forecasts become the basis for the Repair and Overhaul budget of more than $290 million.

10.143 The supply manager is responsible for ensuring that sufficient parts are available to maintain authorized repair pipeline quantities. To do this, all available parts must be known as well as their location, both within DND repair facilities and at contractors' plants.

The Sea King helicopter fleet is adversely affected by the length of time taken to repair "repairable" parts (see paragraph 10.140).

10.144 We found that supply managers were not adequately trained to carry out the inventory management functions related to repairables. They were often unaware of the actual quantity on hand because of data inaccuracies in the supply system, and were more concerned with acquiring additional stock than with following up repairable items that should be returned by repair and overhaul contractors. This latter responsibility is not clearly defined within the Department, and supply managers are ill equipped to perform it.

10.145 The Department of National Defence should improve control over high-cost repairables by improving the reliability of data used in controlling the pipeline, training supply managers in how to determine requirements, ensuring requirements calculations use an approved approach that accurately reflects parts on hand, and assigning responsibility for repairable forecasts to Life Cycle Materiel Managers who have the necessary experience and training.

> ***Department's response**: The Department is currently addressing the problem of control and reliability of data of high cost repairables and the training of supply managers with respect to requirements calculations. Trials are currently under way on a new repair and overhaul control system which will:*
>
> a. *improve repairable turn-around time;*
>
> b. *automatically advise CF units of contractor assignments/changes;*
>
> c. *reduce mis-directed shipments;*

d. allow for management reports produced in-house (vice paying contractors for same); and

e. allow up-to-date inquiry capability.

Improvements, both in the area of training for supply managers and in the control of repairables, will lead to more accurate repairable forecasts. Although this responsibility will remain within the Supply Branch, the need for close consultation with Life Cycle Managers will continue to be emphasized.

Measuring the Impact of Supply on Operational Readiness

10.146 One way of assessing the performance of supply is to measure its impact on the operational readiness of the equipment fleets. Each of the three environmental Commands - land, air and maritime - reports operational readiness in a different way and reports the impact of supply in varying degrees of completeness. DND does not have a complete picture of the impact of supply support on the operational state of its equipment.

10.147 Maritime Command does not report information in a way that permits the impact of supply on operational readiness to be readily assessed. The daily status of the fleet is reported and operational deficiencies are recorded, but no analysis is performed to indicate the impact of supply on operational readiness and how this has been changing over time.

10.148 Air Command reports every month on the percentage of serviceable aircraft in the fleet and the levels of equipment "not operationally ready" because of maintenance or supply. Differences exist between aircraft fleets in terms of how the information is used. For instance, although the Sea King and Aurora fleets are monitored locally for full mission capability and partial mission capability, the national reporting of this combines these categories under "serviceable". For the CF-18 fleet in Europe, the distinction between fully operational and partially operational was not recorded or reported, even locally.

10.149 The percentage of land vehicles serviceable each month is summarized and reported nationally. But the figures are not as useful as they might be because different definitions of the term "operational" are being used. Also, no specific linkage is made between operational status and supply.

10.150 We recognize that there are various definitions of operational status: serviceable; operationally ready; fully and partially mission capable; various categories of restricted operational capability; etc. The concept of operational readiness and its relationship to the missions to be carried out is a complex one. Whatever the definitions, however, the fact is that we encountered situations where weapon systems could not always function in the manner and for the purpose for which they were designed. Therefore they were restricted in their operations because of disruptions due, in part, to an inadequate supply of spare parts.

10.151 The Department makes extensive efforts to handle the many technical and supply problems encountered. But it does not have a fully satisfactory method of tying specific parts problems systematically to their impact on maintenance and operational readiness.

10.152 The Department of National Defence should establish a consistent approach for measuring and reporting the impact of supply on equipment readiness.

> ***Department's response:*** *An operational readiness and effectiveness reporting system is being developed for the Canadian Forces. Included as part of this system will be reporting mechanisms which will indicate the levels of supply support for operational equipment. This system should commence its trial in 1988.*

Management Information and Feedback

Coverage of materiel support by the major assessment processes in DND is incomplete. Management is not adequately informed about the Department's ability to deliver effective support in peace or war.

Reporting to Parliament

10.153 In 1984 we made recommendations for streamlining and co-ordinating feedback mechanisms. We also recommended the development of meaningful and comprehensive measures of overall defence effectiveness for the purposes of reporting to Parliament.

10.154 In the Preface to its Estimates, Part III, DND states that:

> Due to the classified nature of performance indicators used within the Department of National Defence to measure program effectiveness, the disclosure requirements for Performance Information and Resource Justification in Section II of the Program Expenditure Plan cannot be met. However, more general information regarding planned activities, capital projects, etc., has been provided.

10.155 A review of the information that the United States Department of Defense provides to Congress every year leads us to believe that DND could do much more by way of providing meaningful indicators of capability goals, current status, and funds needed to meet these goals. This would provide Parliament with the kind of information it needs to assess progress in meeting goals, and to obtain a sense of relative priorities of, say, force structure, combat capability, readiness and sustainability.

10.156 Several activities under way in DND can help to achieve this type of reporting. Following our previous audit, a Chief of Review Services, reporting to the Deputy Minister and to the Chief of the Defence Staff, was designated to co-ordinate internal audit, program evaluation and military review activities. A new Director of Operational Readiness and Effectiveness reporting to the Deputy Chief of the Defence Staff, is installing an Operational Readiness Reporting System designed to assess the effectiveness of equipment, personnel, training, and logistics for all wartime tasks. We strongly support the objectives behind these initiatives and encourage the Department, as these reporting processes mature, to consolidate the resulting information for Parliament's purposes.

Management Reporting Systems and Effectiveness

10.157 In this audit we reviewed a broad array of reporting systems associated with materiel support – the new Operational Readiness Reporting System, the Defence Activity Performance Measurement System, Program Evaluation Reports, Internal Audit reports, the reports regularly produced by the automated management systems, including the Canadian Forces Supply System, the various maintenance management systems, and several others.

10.158 Despite having many processes providing information on elements of the materiel support system, the Department has not established a report on the effectiveness of the entire system. To achieve this, it would be necessary to consolidate the effectiveness information on the various elements of materiel support, and especially the major elements – supply, maintenance, and transportation. At this time, reporting in these areas is fragmented and incomplete.

10.159 We found that little progress had been made in establishing performance indicators for materiel support. The National Defence Headquarters Information Requirement Working Group noted in June 1986 that, although the Assistant Deputy Minister - Materiel directly influences operational readiness, little attention has been paid to the support functions in either performance measurement or the Operational Readiness Reporting System. As a result, performance measurement is not being used effectively, either within the Materiel group or as a device for reporting to senior management on materiel support.

10.160 We found that, although logistics is one of the four major categories in operational readiness reporting, the current reports fail to provide an assessment of the logistics framework and fail to provide senior management with a complete or useful picture of the state of materiel support within that framework. Reports are provided to commands by the operational units. These reports are passed on to the Assistant Deputy Minister - Materiel. However, no report is provided on the Materiel Group's area of responsibility. There are no operational readiness reports that cover the state of materiel support capability including the arrangements for the definition and management of stocks for war.

10.161 The Supply Concept Paper published by the Department in 1984 noted that a good supply system should have the capability to extract relevant information from the maintenance and transportation systems in order to provide the total materiel support scenario at any operational level. The supply system does not have this "interface" capability. In addition, there is no recognized standard of performance for the transportation system. A study conducted by the Operational Research and Analysis Establishment reported that there was a serious problem in the area of transportation. It recommended the development of a nationwide information system.

10.162 The Department of National Defence should develop comprehensive measures of materiel support effectiveness that cover the full range of Headquarters and Command materiel support responsibilities. Full implementation of such measures can only take place once adequate systems are in place to generate required data.

> ***Department's response**: The recently created Directorate of Operational Readiness and Effectiveness has been tasked to develop an integrated feedback reporting system on the operational readiness and effectiveness of the Canadian Forces. This system, together with the CFSS Upgrade Project enhancements relating to planning and scheduling, and information reporting, will provide the necessary management data. It is expected that this new feedback system will be trialed in 1988.*

Management Information

10.163 During the audit we asked the Materiel Group in Headquarters to provide us with a list of the formal and informal, automated and manual, management information systems used on a day-to-day basis to manage the Group. We reviewed this information along with the Headquarters Information Requirements Study, and we interviewed people at various levels.

10.164 The centralization of support operations places a tremendous burden on the management information system. Under a functional organizational structure, each logistic sub-system extends vertically throughout the chain of command from Headquarters to the first line combat units. Information and feedback must travel long distances in structural terms before they can be used by senior decision makers at National Headquarters. Also, under a centralized system, most of the decision making required throughout the structure goes to the top where officials can easily become inundated by the shear volume of the data with which they must cope.

10.165 The vertical nature of this structure also inhibits the integration of management information until the information reaches the very top, the only place where these systems officially come together. This also places an unrealistic burden on senior personnel in National Headquarters.

10.166 We observed that there has been little progress in the integration of materiel support sub-systems since the Management Review Group identified the need in 1972. Parallel with this, we noted that the automated management information systems for the various sub-systems were also not capable of integration or the transfer of information from one to the other.

10.167 The Department recognizes this problem and an initiative is under way to develop an executive management information system that would link information from the sub-systems and aggregate it for use by senior decision makers in Headquarters. This system, if successfully implemented, would be a major step in alleviating the worst effects of the problems noted, but it is more likely to become a treatment for the symptoms rather than the cause. Some degree of delegation to operational commanders, and major revisions to support doctrine and systems will be required to restore full sustainable support capability to operational formations.

Testing the Materiel Support System in Military Exercises

10.168 Over the last 15 years, the materiel support system has seldom been included as part of military exercises. When it was included, it usually performed poorly, despite the fact that it was usually only partially tested.

10.169 In 1984 we recommended that the Department ensure that comprehensive exercises involving Headquarters and all Commands be regularly scheduled. With the growing interest in readiness and sustainability, it would seem appropriate that the materiel support system be regularly and rigorously put through its paces as part of operational exercises, to ensure that, to the extent possible, it is capable of fulfilling its operational role.

10.170 **The Department of National Defence should fully evaluate the entire materiel support system, on a national basis from Headquarters to the operational units, as part of regularly scheduled, comprehensive Canadian exercises.**

> ***Department's response**: The value of exercises as a means of evaluating the materiel support system through the levels from Headquarters to the operational units is well appreciated. National exercises such as BOLDSTEP and BRAVE LION have been particularly valuable in recent years. WINTEX and LOGEX are command post exercises which can also derive benefits for us. On a more regular basis, RENDEZ-VOUS, MAPLE FLAG, AMF(L) EXPRESSes and MARCOTs can also be used to assess the effectiveness of the overall system or selected systems. The Department will actively pursue all opportunities to exercise materiel support systems in conjunction with scheduled national and international single-service or multi-service exercises.*

DEPARTMENT OF SUPPLY AND SERVICES

DEPARTMENT OF SUPPLY AND SERVICES

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11

DEPARTMENT OF SUPPLY AND SERVICES

The Department

11.1 The Department of Supply and Services (DSS) was created in 1969 as part of a general administrative reorganization of the government in response to concern for efficiency and economy in government spending.

11.2 The mandate of DSS derives from the Department of Supply and Services Act, the Financial Administration Act, the Defence Production Act, a number of Orders in Council and numerous Treasury Board Administrative policies.

11.3 In the 1987-88 Part III of the Estimates, DSS describes its program objective as follows:

> to provide Receiver General programs in the areas of payment and banking services, maintenance of the central government fiscal accounts and associated reports; certain services in the area of compensation and personnel; and common services on a revenue dependent basis, for the supply of goods and certain services required by departments and agencies, and the disposal of Crown owned material; all designed to enhance government efficiency, effectiveness and economy, taking into account the contribution of these activities to the support of national objectives.

11.4 Within government, DSS is known as a common service organization providing goods and services to virtually all federal departments and agencies. DSS provides these goods and services to its clients within a framework of policies established by the Treasury Board Secretariat and the Office of the Comptroller General and with sensitivity to broader strategic objectives of government such as regional or industrial development concerns. According to Treasury Board policies, the primary role of common service organizations is the provision of service to its clients and, within that role, the primary goal is the attainment of maximum value for money. In addition to Treasury Board policy and procedures, many of the activities of DSS are directed or constrained by other authorities such as the Minister of Finance or the governing legislation and policies of the individual departments served by DSS. Therefore, DSS activities are conducted in a complex environment where the objectives of services and value for money sometimes conflict.

11.5 Many of the DSS services are essential to government. Accordingly, DSS's existence as a common service organization is predicated on its ability to provide the required goods and services. This is particularly true in the payment systems area where millions of cheques are issued each month; Canadian citizens and businesses expect to receive them promptly. In this regard DSS has developed a strong management orientation to service.

11.6 To deliver its services, the Department employs approximately 10,000 people and is organized into five sectors:

- Management and Operational Services Sector, responsible for the overall management and functional direction of the Department's accounting, computing and other related services;
- Supply Operations Sector, responsible for the overall management and direction of procurement operations;
- Regional Operations Sector, the vehicle for the day-to-day delivery of the Department's services through a national network of District Services Offices and Regional Supply Centres;
- Finance, Personnel and Administration Sector, which provides corporate administrative support to the Department; and
- Corporate Planning and Policy Sector, which provides planning, program direction and policy formulation and review for the Department.

Audit Scope

11.7 The scope of this audit was to evaluate management controls, both operational and financial, over the delivery of the services managed by the Management and Operational Services Sector and jointly delivered with the Regional Operations Sector. In this context our audit was particularly concerned with DSS's ability to deliver cost-effective products; that is, to deliver a product of acceptable quality, in terms of accuracy, timeliness and completeness, at a reasonable cost. Those services provided by the Audit Services Bureau and the Bureau of Management Consulting were excluded from the scope of this audit. Significant remaining segments of the Department will be audited in future years.

11.8 The audit was also designed to address the objectives of the Office's government-wide Financial Management and Control Study, reported in Chapter 4 of this Report.

11.9 The first section of this chapter addresses the major issues related to the management of productivity. In it, we focus on the comparison of DSS product costs with those of other organizations, the comparison of productivity levels within the Department's District Services Office network, and the quality of performance measurement systems. We conclude with a discussion of management's role in leading the organization toward achieving a high level of productivity.

11.10 The second section addresses issues related to the management of automation. It sets out an assessment of the extent and quality of the Department's current automation support, the technology and systems development activities within the Department, the controls over computer support and the pattern of spending on automation. The section concludes with a discussion of management's role in leading the organization toward realizing the maximum benefits of automation.

11.11 The third section of the chapter contains our observations on financial management and control and places special emphasis on issues of accountability.

11.12 The fourth section sets out our overall audit conclusions and recommendations.

11.13 The final section contains the Department's response to this chapter.

Management of Productivity

11.14 DSS carries out a range of functions for the Government of Canada. These include the delivery of such familiar and necessary services or products as payroll, pension, cheque issue and accounting. Providing these services or products requires handling and processing significant volumes of information.

11.15 A clear and strong focus on the management of productivity is essential to achieving cost-effectiveness in the operation of a production process and the consequent delivery of products. This part of our audit sought to determine the extent to which DSS:

- compares its product cost performance with that of other organizations;
- manages the relative productivity levels of its District Services Offices;
- has the performance measurement systems in place for monitoring productivity and for planning improvements; and
- has adopted product management techniques aimed at encouraging cost-effective product delivery.

External Product Costs

11.16 The cost of products delivered by a service organization should be a major criterion in assessing its overall cost-effectiveness. Product costs should compare favourably with those of similar organizations.

11.17 DSS does not have current comparative product cost information. We believe such information is necessary for an assessment of DSS cost-effectiveness. Therefore, we selected the two largest DSS products, Public Service Pay (Pay) and Public Service Superannuation (Superannuation) for comparison with the product costs of two provincial governments. Pay and Superannuation products account for 35 per cent of the total departmental expenditures within the scope of this audit. DSS provides pay services for 320,000 employees and handles 470,000 contributor and pensioner accounts.

11.18 The results of the comparison, shown in Exhibits 11.1 and 11.2, indicate that DSS unit product costs are significantly higher than those of the provincial governments we reviewed; the quality of service is essentially the same for all three organizations.

Exhibit 11.1

EXTERNAL COST COMPARISONS
Public Service Pay Annual Unit Costs

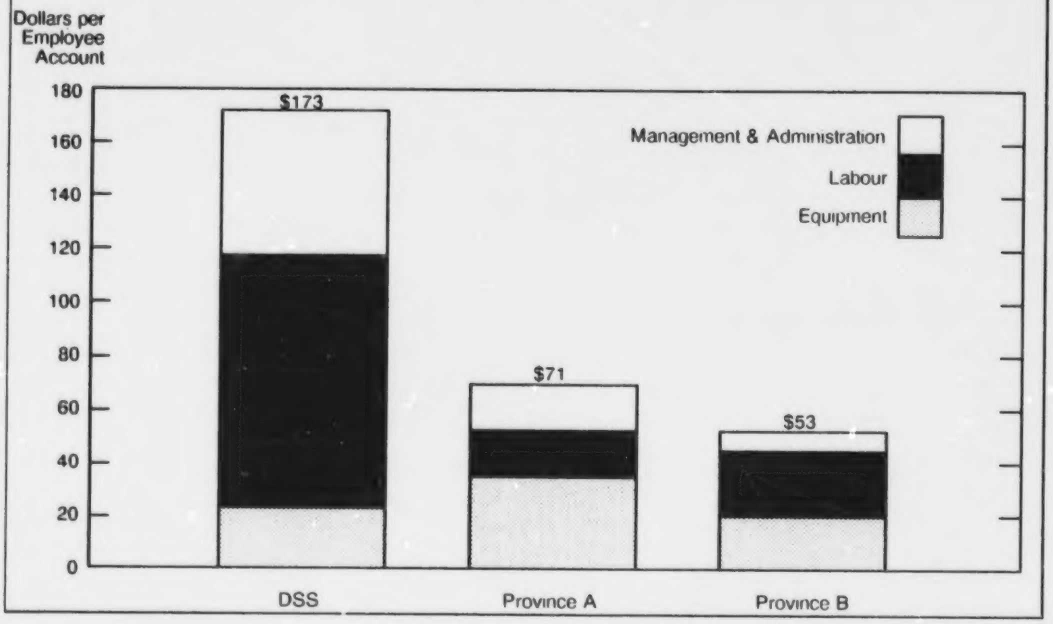
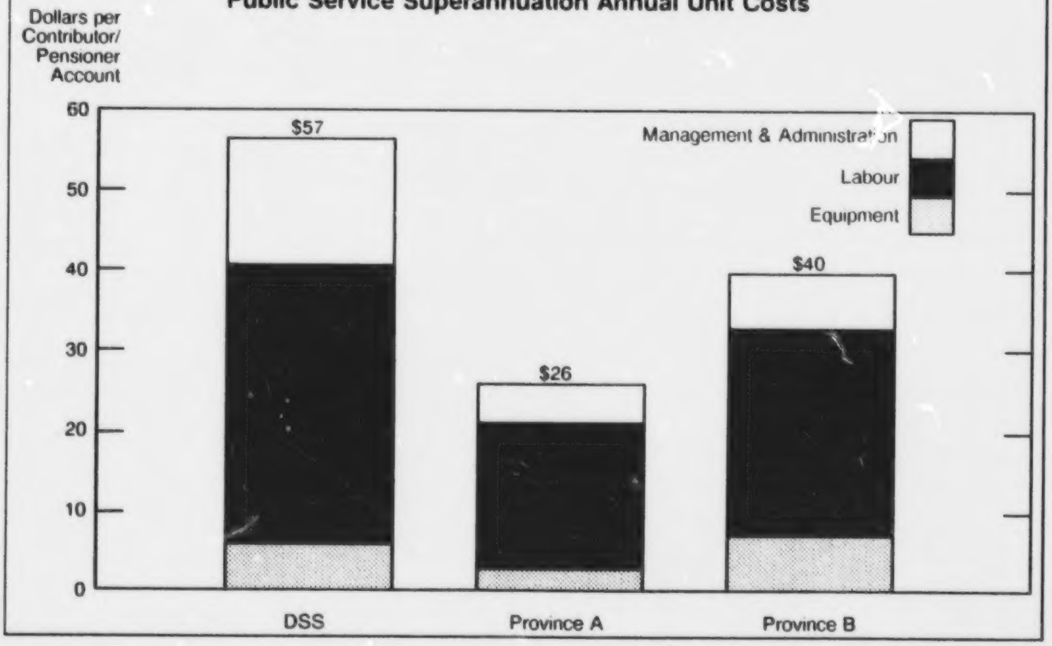


Exhibit 11.2

EXTERNAL COST COMPARISONS
Public Service Superannuation Annual Unit Costs



11.19 Based on these unit product cost differences, we estimate that the combined annual cost gap for the Pay and Superannuation products is in the order of $46 million. This cost gap will not be fully eliminated by the federal government because certain environmental factors such as the wide geographical dispersion of the public service and DSS services offices, the large number of collective agreements and payroll deductions, the federal government bilingualism program, regionalization and other policies contribute to the federal product costs. Estimates of the cost resulting from these factors are not available, but we believe that the fundamental cause of the cost gap is that DSS has not fully exploited the benefits available from automation.

11.20 Both the provinces we reviewed in this comparison have made substantially more headway in automating their Pay and Superannuation products, resulting in significantly lower labour and management and administration costs.

11.21 DSS management indicated to us that automation of the Public Service Pay and Superannuation systems has been slowed by two factors. First, over the past decade management has been very cautious in instituting change as a result of an unsuccessful payroll system development experience in the early 1970s that caused disruption in the service provided in this area. Second, rapid technological change created the requirement to convert the various vendors' technologies being used to a single compatible technology before more fundamental change could be achieved. The conversion to single technology is now virtually complete, and DSS is currently proposing to increase substantially its level of automation, replacing both the Pay and Superannuation systems with a single Public Service Compensation System.

11.22 We support the Department's conversion to single technology and view it as a major step forward, without which DSS could not have positioned itself to significantly improve the quality of its systems.

District Services Offices

11.23 DSS delivers its products through a regional network of District Services Offices (DSOs). Consequently, the relative productivity of these operating units is important to the Department's overall cost-effectiveness. Comparative information on their productivity is a basic tool for identifying productivity problem areas. It is also a prerequisite to corrective action.

11.24 The Regional Operations Sector has a Support Directorate of 113 persons at Headquarters, about half of whom are responsible for providing functional guidance to DSOs, developing and operating a Sector Management Information System, analysing and interpreting Sector performance variances, and providing resource allocation information.

11.25 Despite this central group, we found that there was no useful comparative DSO productivity information available at DSS Headquarters.

11.26 In the absence of such information, we calculated comparative productivity information using available basic DSS data on business volumes and person-year utilization for the 1986 fiscal year. We confirmed these data during our on-site visits to eight DSOs.

11.27 This basic productivity analysis covered all DSOs and examined the work of approximately 1,000 person-years directly employed in delivering these products or services:

- Data Capture;
- Public Service Pay; and
- Account Payments of the Government of Canada.

11.28 Our analysis indicates that there were wide variations in productivity performance within the DSO network (see Exhibits 11.3, 11.4 and 11.5).

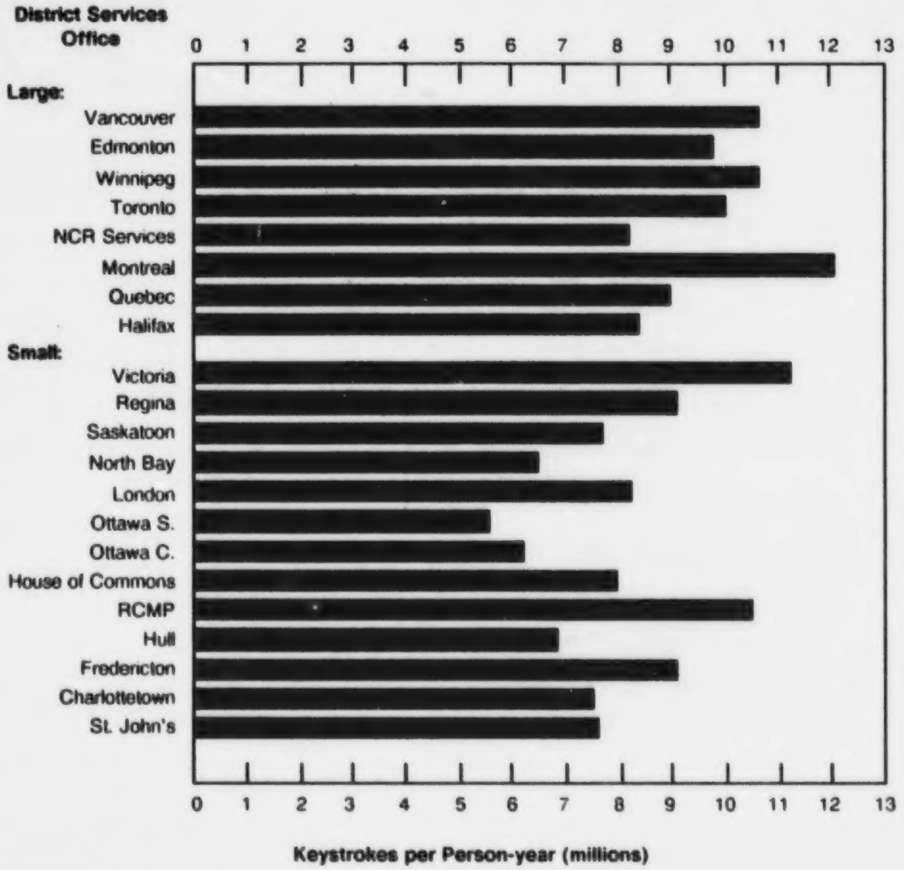
11.29 Using the achieved performance level of the most productive or second most productive large DSO as a performance standard – even though this is not necessarily an ideal level of performance – we estimated that the potential for overall productivity improvement in Regional Operations ranged from 10 per cent to 14 per cent. This estimate was based on 1986 results for the three products in our sample. DSS management indicated that the Sector has recently reduced its person-year allocation by 150 from 1986 levels. In our opinion, there are further long-term opportunities for productivity improvement in the range of 5 per cent to 9 per cent. Annual savings could range from $3.5 million to $6.5 million.

11.30 In carrying out our comparative productivity analysis, we observed a number of situations that contribute to varying productivity levels among DSOs:

- There are major differences in the extent of quality review work performed on pay transactions. Some DSOs review 100 per cent of their transactions while others perform limited review.
- There are major differences in the extent of data capture keystroke verification work performed. The amount of keystroke verification performed varied widely by DSO, from a low of 1 per cent to a high of 99 per cent.
- Many offices make very limited or no use of part-time employees to do data capture work. An internal study in one office indicated that savings could be obtained by having some data capture work done by the private sector.
- Some DSOs handle a higher than expected number of client requests for urgently required cheques. These cheques are usually prepared manually rather than by the computer. The manual preparation process is clearly labour intensive.
- DSS management adopted a standard organization structure for Regional Operations. As a consequence some DSOs maintain support structures in excess of those required to handle their business volumes. DSS management is reviewing this standard structure.

Exhibit 11.3

DISTRICT SERVICES OFFICE COMPARATIVE PRODUCTIVITY
Data Capture



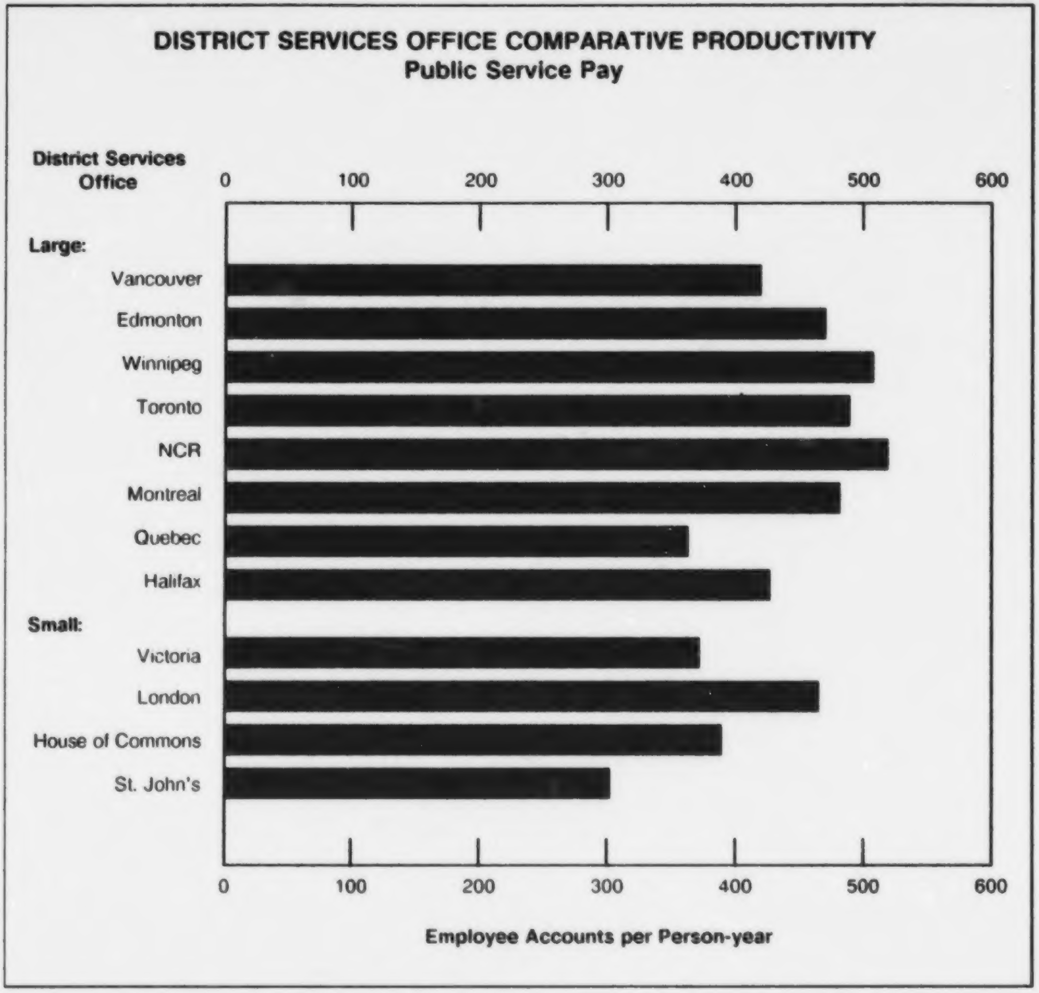
- Our review of organization charts indicated an average staff-to-supervisor ratio of 4:1 (20 per cent), five management levels and 30 cases of one-to-one reporting relationships (see Exhibit 11.6).

11.31 We believe that the lack of comparative productivity information and the situations just described indicate a lack of necessary central management direction for the development of uniform and efficient product delivery practices in all District Services Offices.

Performance Measurement Systems

11.32 Sound productivity management depends on reliable and timely information, including that produced by performance measurement systems. Such information should provide the basis for allocating resources and controlling costs throughout the organization.

Exhibit 11.4

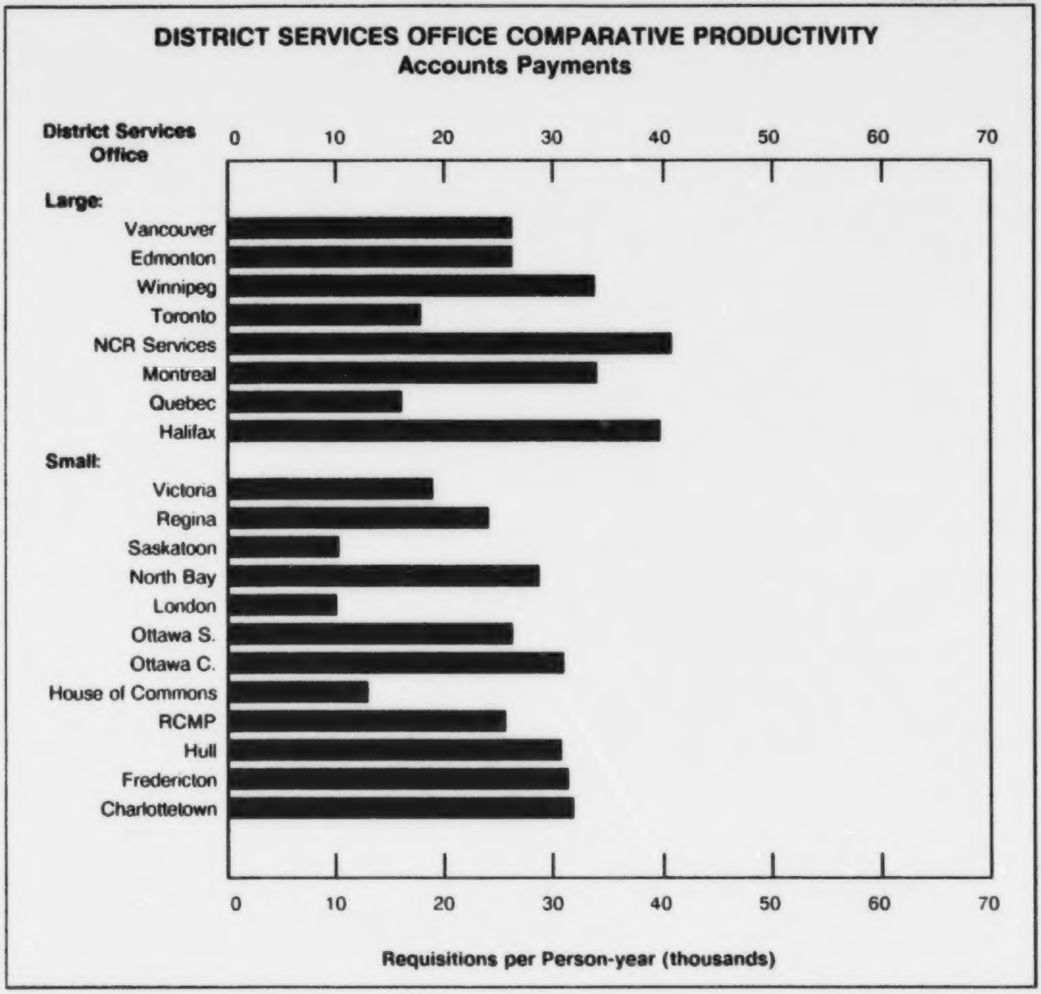


11.33 Our review indicated that there are several national and local systems providing performance measurement information of various types in the Regional Operations Sector.

11.34 Clearly, DSS has spent considerable time and resources in developing and operating its various performance measurement systems. These systems, however, have not had the desired effect of contributing significantly to improved cost-effectiveness of DSS product delivery or to closing the gap in DSO productivity variances. We believe that the DSS performance measurement systems are ineffective because:

- comparative DSO productivity variances are not highlighted, and the resulting effects on product costs are not determined;
- performance standards are not changed as operating processes change, and therefore they become obsolete over time;

Exhibit 11.5



- a large proportion of the work performed is not covered by these systems;
- insufficient use of computer-generated transaction counts results in excessive manual effort;
- report processing is too slow and report delivery is unreliable; and
- the data produced by the systems are not being used for management control and resource justification purposes.

11.35 The primary system in DSS for providing cost-related performance measurement in its regional operations used to be the Performance Measurement System (PMS). This system had some weaknesses and was discontinued in 1986 – DSS was left with

Exhibit 11.6

EXTENT OF SUPERVISION

District Services Offices

Office	Supervisors as a Percentage of Total Staff	One-to-one Reporting Relationships
Vancouver	22%	1
Edmonton	20%	2
Winnipeg	25%	4
Toronto	14%	1
National Capital Region		
Regional Pay Office	15%	2
Central Pay Office	15%	0
Services Office	13%	0
Montreal	23%	4
Quebec	22%	3
Halifax	22%	1
Large Offices	18%	18
Victoria	27%	1
Regina	34%	2
Saskatoon	29%	0
North Bay	34%	2
London	30%	2
Ottawa South	19%	0
Ottawa Centre	12%	0
House of Commons	31%	2
RCMP	26%	0
Hull	25%	1
Fredericton	35%	1
Charlottetown	25%	0
St. Johns	33%	1
Small Offices	26%	12
All Offices	20%	30

no cost-related performance measurement information. DSS is planning a new national performance measurement system and proposes to use historical productivity as a basis for comparison. This new system will be useful, but without national performance standards, it will be insufficient to meet the requirements for aggressive product cost management. DSS management has indicated that national standards may be considered in the near future.

11.36 In summary, senior DSS management does not have adequate tools to measure and report on the productivity of its regional operations. Therefore budgets are prepared on an historical basis adjusted for the impact of changes. The inadequacy of such systems denies management the proper tools to control product costs and to perform effective budget challenge.

Role of Management

11.37 Delivering a quality product economically is not accidental. A major prerequisite is a management philosophy directly aimed at reaching this objective. This philosophy almost always emanates from the top and can be seen to permeate the whole organization.

11.38 Some important characteristics of sound management of product delivery include:

- setting precise product cost and quality of service targets for each product, in line with industry standards;
- developing detailed strategies and plans to achieve each target;
- designing and implementing efficient production processes;
- using cost and performance measurement information systems to monitor actual product performance against plans;
- directing careful attention to achieving planned cost targets, investigating significant variances and applying corrective action where appropriate; and
- establishing clear and effective accountability relationships for product cost and quality throughout the organization.

11.39 If DSS management is to lower its product costs significantly, improve productivity levels of its DSOs and develop meaningful performance measurement systems, while maintaining the current acceptable product quality, then these characteristics of sound product delivery management will need to be fully developed and implemented.

Management of Automation

11.40 DSS operates one of the largest computer complexes in Canada. Effective management of automation is, therefore, an important contributor to the delivery of cost-effective products.

11.41 Good management of automation makes its contribution by providing a cost-effective computing network that performs work for and provides information to production personnel, allowing them to deliver their products at minimum cost. Sound management of automation further contributes to the cost-effectiveness of products by controlling the costs of the services provided to the organization.

Use and Quality of Automation

11.42 Because computers represent a large annual cost to DSS and play such an important part in delivering DSS products, we reviewed both the amount of computer support and the extent to which this support met the needs of the people that must deliver the products.

Automation has failed to eliminate the use of manual ledger cards in DSS (see paragraph 11.45).

11.43 We again selected the Public Service Pay and Superannuation products as points of reference for our assessment because they represent the largest products delivered by DSS.

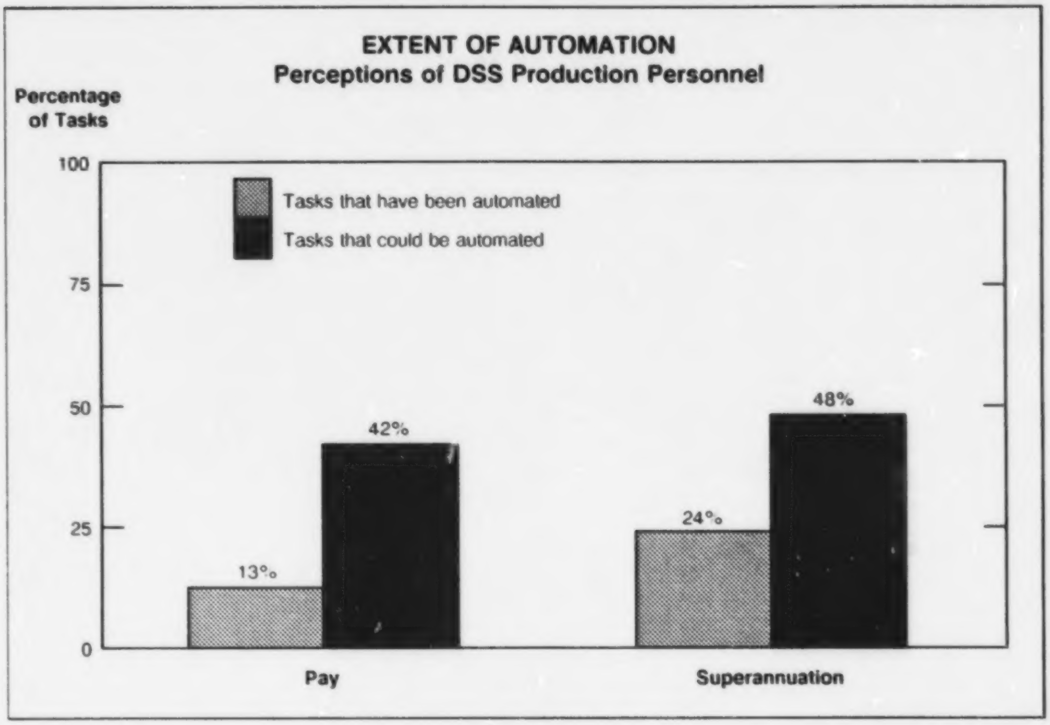
11.44 We conducted interviews, surveyed the opinions of a wide cross-section of DSS personnel, and examined relevant supporting documentation.

11.45 During our review, DSS personnel indicated that there are significant opportunities for automation. These relate not only to developing new systems but also to improving existing systems that do not deliver the intended results. Some of the major automation opportunities identified by DSS production personnel include:

Public Service Pay

- automating the payroll deduction and remittance control function;
- upgrading the Salary Service Data Base; and
- automating manual ledger cards maintained for each government employee. (If this process were automated, it would eliminate the duplication of detailed employment records maintained by DSS and client departments, and could result in a significant reduction of annual operating costs for DSS and its client departments.)

Exhibit 11.7



Public Service Superannuation

- automating the transfer of payroll information to the superannuation system; and
- automating the transfer of information between the superannuation entitlement and payment components.

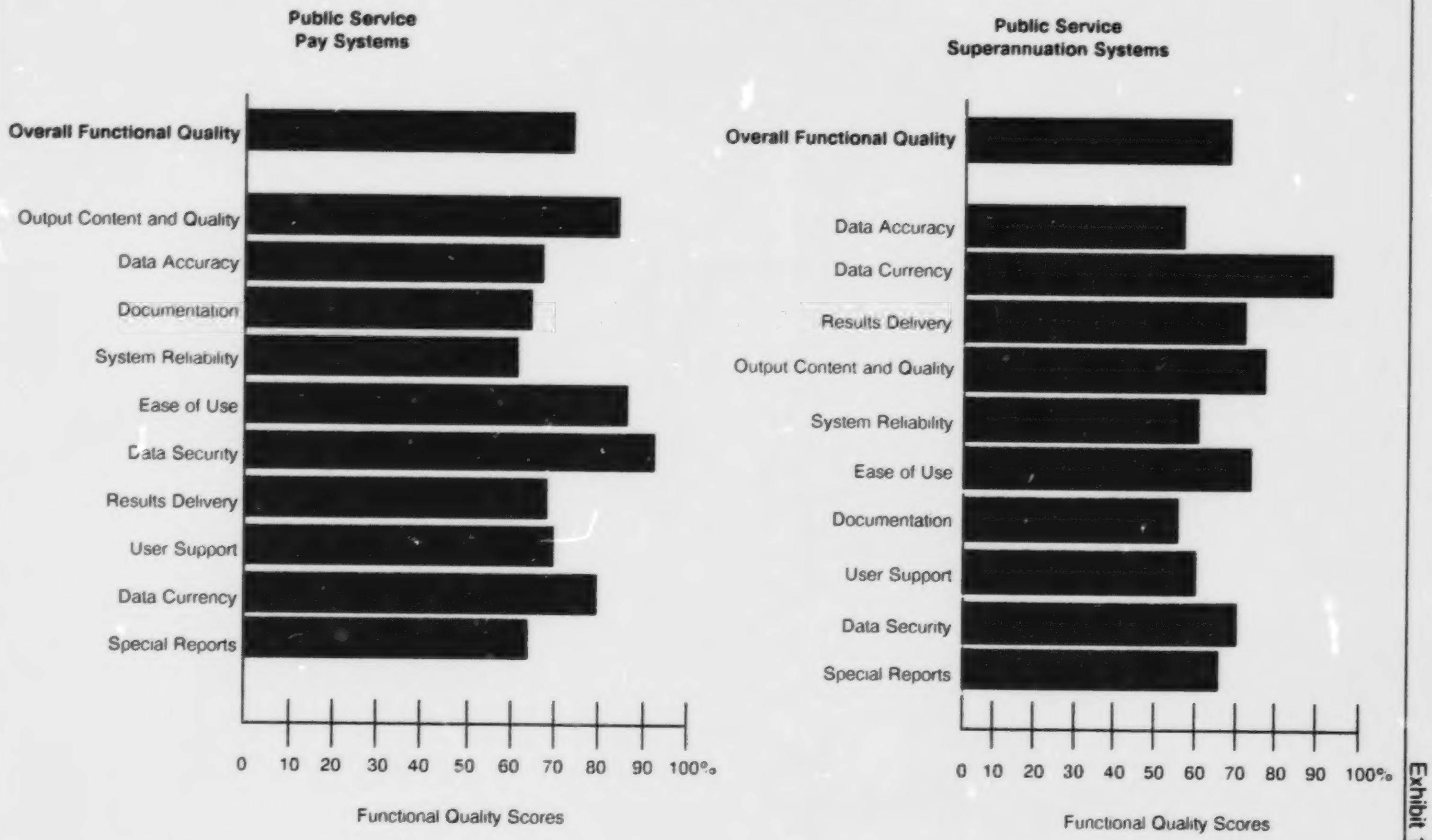
11.46 For an overall perspective, we asked DSS production personnel to identify all the significant Pay and Superannuation product delivery tasks they were required to perform. From this inventory of total tasks, we then asked them to identify which of the tasks they believed could be automated and those that already were.

11.47 The results of this survey are set out in Exhibit 11.7, clearly indicating the potential for eliminating a considerable amount of manual work.

11.48 We also asked DSS production personnel to rank in order of importance the functional characteristics of the automation support they were receiving and then to rate each characteristic in terms of quality. Exhibit 11.8 shows the nature of the characteristics and the results of this survey.

Exhibit 11.8

QUALITY OF FUNCTIONAL CHARACTERISTICS
Perceptions of DSS Production Personnel
(Ranked in Order of Importance)


Public Service Pay Systems

Public Service Superannuation Systems

11.49 Among the various functional quality characteristics surveyed, data accuracy was judged to be very important, but it received a surprisingly low rating. This low rating indicates that considerable manual intervention is required in the processing of transactions to ensure that the final results are accurate.

11.50 The external product cost comparisons indicated that DSS was spending, on a per unit basis, about the same amount of money on automation, in terms of equipment, as were the two provinces we reviewed (see Exhibits 11.1 and 11.2). We concluded that DSS needs to improve significantly the quality of its automation in order to enhance the benefits it is realizing from its overall spending in this area.

Development of Technology

11.51 DSS was formed from a number of organizations that were carrying out different information processing activities. The amalgamated organizations had been operating with computers supplied by various manufacturers. These computers were not compatible and therefore many of the benefits normally expected from integrating and rationalizing systems were not immediately available to the newly formed Department.

11.52 After considerable study, DSS concluded in 1982 that there would be savings if it were to rationalize its existing multi-technology data centres across Canada and create a single technology environment. DSS further concluded that it should reduce the number of data centres from five to two. Savings under this approach were projected to be $29 million per year by 1990-91. At the time of our audit, DSS was in the final stage of converting the technology and consolidating its data centres.

11.53 This initiative by DSS, although late in coming, is a progressive step and a necessary one. As indicated before, we support this initiative, however we have two observations regarding the financial management controls over its implementation:

- Working papers documenting estimated costs and benefits have been misplaced. As a consequence, we were unable to draw conclusions about the adequacy of the analysis prepared in support of this major initiative.
- Total project costs are not being accurately accumulated or adequately monitored. As a result, some costs described as conversion expenses are being charged to other projects.

Development of Systems

11.54 An organization, such as DSS, that delivers common data processing products requires computer systems that allow personnel to produce products efficiently and economically. Management controls over planning and carrying out systems development projects should therefore ensure that the cost of automation development is minimized and that the potential benefits of automation are realized and reflected in lower product costs.

11.55 We reviewed DSS management controls over selected major system development projects and examined their progress through all stages of development from inception to the present. For this review we selected projects that are instrumental in supporting the compensation and financial control activities of the Government of Canada.

11.56 Our results are summarized in Exhibit 11.9. Case histories of these projects are included at the end of this section.

11.57 The overall results of our review indicate that the computer systems development experience at DSS has not been consistently successful. Although there has been improvement in recent years, systems development projects have not always fulfilled their objectives and have not always been completed on time. These inconsistencies have certainly contributed to high DSS product costs. More important, we believe the lack of success in realizing planned production cost savings confirms the need for greater management attention to product costs.

11.58 Our detailed review of these system development projects shows that objectives have not often been defined in sufficient detail prior to project approval. As a result, the effects on other activities and the constraints imposed by them have not been given adequate consideration, leading in most cases to expensive delays in development.

11.59 Users and DSS personnel directly involved in delivering end products often did not have a continuing primary role throughout the project development activity. This was a major reason for some of the projects failing to meet planned objectives and for DSS production personnel being dissatisfied with the resulting systems.

11.60 Projects have often been carried out without the benefit of a co-ordinated systems development plan. As a result, systems were being developed without consideration of the overall needs of DSS production personnel or of the end users.

11.61 There was no standard approach used for costing and monitoring projects, and methods that were in use often did not break the project into controllable activities or track overall costs. As a result, project cost overruns, shortfalls in projected savings and delays in project completion often went unnoticed.

11.62 Projects were not identified with intermediate objectives at a level of detail that would facilitate project management. When objectives are very broad, progress or lack of it can be virtually impossible to track.

11.63 DSS systems development staff come from a variety of backgrounds that includes a number of computers supplied by various manufacturers. Few have had an opportunity to develop the skills needed for handling effective interaction with users in a single technology environment that may still be somewhat unfamiliar to them.

Exhibit 11.9

SUMMARY OF SYSTEMS DEVELOPMENT PROJECTS EXAMINED

Project	Developed on Time	Developed Within Budget	Resulted in Planned Savings	Met Development Objective
Salary Service Data Base	No	No	No, resulted in added procedures / costs	No
Superannuation Contributor System	No	Cost tracking not possible	No, resulted in added procedures / costs	No
On-Line Pay Entry System	Yes	No	Yes, but less than forecast	Yes
Account Payment on Due Date System	Yes	Cost tracking not possible	Contributed to improved economy in government cash management operations	Yes, though concern over efficiency

11.64 DSS management has recently developed policy initiatives intended to improve the way in which systems development projects are initiated and managed.

Case 1: Public Service Pay Salary Service Data Base

11.65 The purpose of this project, initiated in 1978 with planned implementation for 1979, was to develop an automated history file of payroll transactions that would replace the manual ledger card system then in use. The information collected by this data base would allow calculation of retroactive pay and provide data for the new Superannuation Contributor System. Initial estimates indicated that annual savings from this project would amount to $900,000 and that development would cost approximately $150,000.

11.66 Initial implementation took place between 1981 and 1983, but it was discovered that the Contributor System requirements had changed and that the system would no longer satisfy user needs. The program was reworked and reimplemented in early 1983. However, there were so many problems with the quality of the data loaded into the system that a fresh start had to be made in early 1984. Users are still sceptical about the quality of the data and find that the system requires additional clerical effort.

11.67 The system is currently supplying data to the Contributor System, but it has not replaced the manual ledger card system, and its information is of limited value for retroactive pay calculations. Total development costs increased five-fold to over $800,000.

Case 2: Public Service Superannuation Contributor System

11.68 This project was initiated in 1976 to provide a data base of pay and pension information that would ultimately be used for automatic benefit calculations. Initial cost estimates called for development costs of $550,000 and annual operating costs of $190,000.

11.69 Many changes in project objectives took place over the life of this project. Eventually, in late 1978, the detailed design was completed, but it was restricted to contributor record maintenance only. The overall project was divided into several projects.

11.70 The redefined original project was completed in early 1981. Post-implementation evaluation of the system indicated that no savings were achieved and, in fact, the system required additional clerical effort. Annual operating costs were $950,000 more than original projections. The project to automate benefit calculations was also affected by similar changes in definition and completion date.

11.71 The Superannuation Branch is dissatisfied with the system because the data quality is questionable, staffing costs are higher than before implementation, and there is no adequate audit trail. As a result, operations staff are reluctant to use the system.

Case 3: Public Service On-line Pay Entry System

11.72 This project was started in 1981 with the objective of improving productivity in the Pay process by reducing the paper burden between departments and DSS. The development plan included establishing a prototype system. Estimated total development costs were $440,000. This project was later combined with the on-line standards development project. At this point, the combined development costs were estimated at $940,000.

11.73 In 1984, evaluation of the on-line pay pilot project indicated that the new system allowed for significant improvements in processing time and required less data entry effort. During the pilot project stage, users actively participated in refining the system. As a result, users interviewed reported that the system was useful and that they would not want to return to the manual system. Final costs for development amounted to $1,170,000. On-line pay input has since been expanded to more than 20 other government departments.

Case 4: Account Payment On Due Date System

11.74 The Payment on Due Date project was started in 1985 to support a government decision to improve economy in its cash management operations by scheduling government-wide payments to suppliers based on due date, automating the payment of interest penalties on overdue accounts and providing reports on this activity to ensure compliance with Treasury Board policy in this area.

11.75 In response to Treasury Board requirements, the project was initially scheduled for completion by March 1986. Because of the limited time available, the normal development procedures were bypassed. Neither formal project initiation nor design documents and accompanying project cost estimates were prepared. Functional specifications underwent many major changes, and they were not properly documented.

11.76 The project is now complete, and DSS management believes it has met its development objectives. However, we noted that the system does not provide detailed listings supporting month-end accounts payable balances. This has made departmental reconciliation of these balances – an important procedure in finalizing the Accounts of Canada – uneconomical and inefficient. DSS, in conjunction with the Office of the Comptroller General and other departments, is now investigating ways of providing an automated method of reconciling these balances.

Controls over Computer Support

11.77 Computer support plays a key role in delivering the Department's products and services. Effective management of automation depends to a high degree on the quality of management controls over this support. Therefore, the focus of our review was on the quality of controls exercised by the Department's Information Systems Directorate (ISD) over its computer support to all DSS products or services.

11.78 We examined the management control systems in place in the areas of planning, production, applications, human resources and administration. The objective of this review was to assess whether the control systems in place were adequately balanced and provided sufficient guidance for management.

11.79 We found a great deal of imbalance among the management control systems. Controls were deficient in relation to understanding user needs, planning and determining the priority of needed computer system changes, controlling both system and development changes, planning for the appropriate mix of human resource skills, disaster recovery, contingency planning and management information systems. Basic controls that serve as mechanisms for controlling resources are adequate. But those related to managing them are not.

11.80 For example, in the planning area, there was adequate control over documenting major application opportunities, identifying appropriate technology to support DSS applications and establishing procedures for reviewing, approving and updating plans. However, we noted that control systems were absent or weak in several key segments, such as:

- setting priorities for system opportunities, including such factors as risk and business impact analysis;

- establishing procedures to develop project cost estimates, considering technology used, users and equipment requirements;

- identifying long-range information requirements and developing plans to meet them; and

- setting out a strategy to involve users in planning and implementing applications.

11.81 In the production area, control systems were weak in the areas of disaster recovery, contingency planning, co-ordination of changes in production systems, and cost accounting.

11.82 In the applications area, we found inadequate procedures to ensure that expected project benefits are realized and that users participate in systems planning and design. There was no effective information system to provide management with adequate cost and resource information on application activities. This reduces management's ability to monitor and control expenditures in this area.

11.83 In the human resource area, controls that address the basic requirements imposed by a federal employment system were adequate. This was particularly noticeable in the areas of skill requirements for specified staffing levels, performance criteria for job responsibilities, and recruiting programs to attract qualified applicants. But there were no management control systems intended to monitor and assure an appropriate mix of skills among ISD staff. These include ways for evaluating and establishing appropriate requirements for information technology skills for ISD on an aggregate and individual basis including technical, functional and managerial skills, and ways for conducting performance reviews based on project evaluations.

11.84 DSS has recently investigated opportunities to improve the productivity of the 800 people working in the Information Systems Directorate. The cost effectiveness of various contracting-out options is also being explored. These initiatives have already resulted in a reduction of 88 person-years.

11.85 Finally, in the administration area, we found that control systems were weak in the area of communicating systems changes to users and staff, and in project budgeting, performance measurement and cost accounting systems.

11.86 Cost information related to computer systems is an essential management tool for controlling computer costs and for financial planning. In this regard, we reviewed the main reporting systems that provide ISD management with information on computer systems cost. These are the corporate financial information system and the project management system.

11.87 We believe that the existing management information systems do not provide the Department with full or consistent cost information on computer system development, maintenance and production activities. Consequently, managers are unable to monitor and control the activities properly, and senior management has insufficient information for strategic planning decisions. Examples of deficiencies:

- The corporate system does not allow accounting and reporting of costs by project phase, task or system.
- Life-cycle systems costs are not available.
- Overhead and some elements of EDP costs, such as operations and data capture, are not allocated to the individual systems.
- There is no assurance that all direct costs have been recorded in the project management system since there is no reconciliation with the corporate system.
- There are inconsistencies in the project management system for reporting outside professional services, other expenditures, and establishing standard charge-out rates. The accounting treatment varies between organizational units in the Directorate.
- Costs of maintenance and production are not separately accounted for by application or system.

11.88 DSS has started to develop measures intended to address many of the above concerns.

Spending on Automation

11.89 DSS makes a substantial investment in information technology. Annual direct expenditures in this area during the years 1984 to 1987 increased from $65 million to $80 million. This represents almost one-quarter of total DSS expenditure within the scope of this audit for these years.

11.90 Exhibit 11.10 is an analysis of how this information technology investment is spent in terms of conversion to single technology, production (operating the computers), systems maintenance and enhancement, and development of new systems.

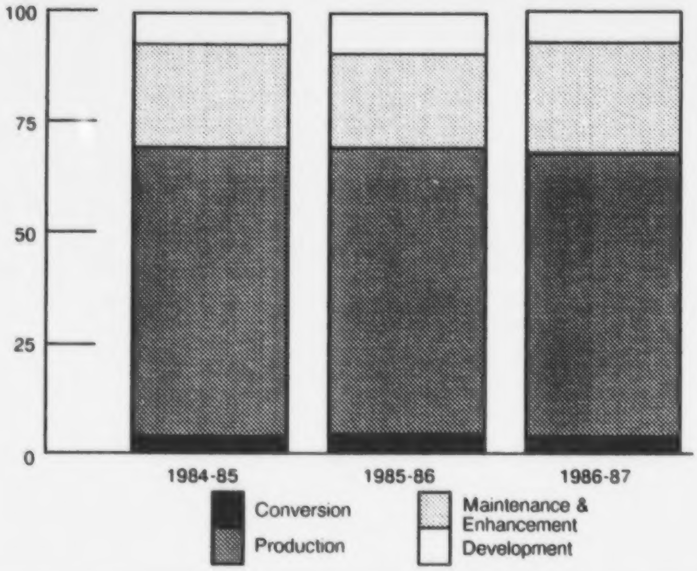
11.91 The percentage of funds spent on the various components of information technology has remained static over these years. The relatively low percentage of spending on new development, approximately seven per cent, reflects an emphasis on day-to-day operations. In our opinion, if this pattern of spending is continued, it will contribute to a decline in the quality of DSS systems.

Role of Management

11.92 In a large organization such as DSS, where over 800 person-years are devoted to developing, maintaining and operating computer systems, the provision of cost-effective automation support should be a constant goal of management.

Exhibit 11.10

SPENDING ON AUTOMATION
Percentage of Information Technology Investment



11.93 Some important characteristics of sound management of automation support include:

- aggressively identifying requirements for automation support where it is cost justified;
- developing and implementing automation that successfully meets the needs of production personnel and other users and meets management's cost savings expectations;
- developing and implementing high quality automation support, on time and within budget;
- developing a pattern of spending on automation that balances day-to-day operational needs with new system development opportunities;
- using cost and performance information systems to monitor automation costs;
- developing an appropriate mix of human resource skills; and
- establishing clear and effective accountability relationships for the delivery of automation support services.

11.94 If DSS management is to improve the quality, extent and control over its automation support, improve its record of systems development, and obtain maximum value for its spending on automation, then these characteristics of sound management of automation will need to be fully developed and implemented.

Financial Management and Control

11.95 The government-wide Financial Management and Control Study, reported in Chapter 4, distinguishes between financial control and financial management. Financial control means that assets owned by the government should be properly recorded and protected; accounting data should be accurate and reliable; and funds should be spent only for those purposes stated and within limits approved by Parliament. All this is achieved by good internal control systems designed to provide internal checks and accounting control over financial transactions. Financial management is a more modern concept that requires that resources be managed economically, efficiently and effectively and not merely controlled. For good financial management to exist, two elements must be satisfied. First, decision makers should have the information necessary to allocate resources and to manage operations with due regard for economy, efficiency and effectiveness. Second, managers must account for how they used the resources they were given.

11.96 Based on the audit work performed, including substantive and procedural testing for the annual Public Accounts and based on the conclusions of recent DSS Internal Audit reports, nothing has come to our attention that would indicate that there are significant deficiencies in financial control systems or in the accuracy, timeliness and completeness of products covered within the scope of this audit, except for our concerns expressed in paragraph 11.76.

11.97 However, throughout this chapter we have described situations where the tools required for sound financial management have been inadequate or missing. We believe that these weaknesses have been a major contributing factor to high product costs.

11.98 In the Management of Productivity section, we noted that DSS has not conducted recent product cost comparisons with those of similar organizations. We also noted that DSS is not monitoring the relative productivity of its network of District Services Offices and does not have suitable performance measurement systems in place.

11.99 In the Management of Automation section, we described various financial management deficiencies related to the quality of automation, the development of technology, the development of computer systems and the quality of cost accounting controls over computer support activities.

11.100 Financial accountability, another important tool of financial management, is provided to Parliament and central agencies through Part III of the Estimates and the Operational Plan Framework.

11.101 For a service delivery organization such as DSS, Members of Parliament should be provided with information that allows them to evaluate whether the services provided by the Department are delivered in a cost-effective manner. We found, however, that the information in Part III, which is centred around the organization structure, fails to provide a clear picture of the nature and costs of the services or products provided by DSS. We believe that Members of Parliament should be aware of the full costs of significant DSS products.

11.102 The performance indicators used in Part III to justify resources are not meaningful. For example, under the Regional Operations activity, the performance indicators shown provide information on payment volumes as well as average productivity per "direct person-year". These indicators combine unrelated products; for instance, the payments volume is shown as 140 million cheques, but 95 million of these are socio-economic cheques (such as Family Allowance, Old Age Security and so on). Only 60 of 2,100 person-years in the District Services Office network are dedicated to this type of payment. By contrast, approximately 11 million public service pay cheques are handled by 650 person-years. Resources cannot be properly justified using such global or aggregate indicators.

11.103 The Operational Plan Framework, which is intended to provide the central agencies with information on the relationship between results and resources, suffers from the same weaknesses. We also noted that the Department's results statements are too general and at too high a level to hold managers responsible for their performance.

11.104 In addition, the linkage statements used by DSS in its Operational Plan Framework do not adequately link resources with results.

11.105 Human resources are DSS's largest single expense. But current management information systems in the Regional Operations Sector do not provide management with adequate tools to support its human resource requirements. As a result, the budget challenge performed by the financial function becomes, in our opinion, ineffective.

11.106 Although we believe that financial management is a shared responsibility of the senior executive group in the Department, it is the senior financial officer who should be the focal point for financial management within the executive group. Therefore, the senior executive group should request – and the senior financial officer should ensure – that management information systems are fully developed and implemented.

Conclusions and Recommendations

11.107 DSS has a productivity problem because the Department, while maintaining adequate product quality, did not give enough attention to product cost and did not fully exploit the benefits available from automation.

11.108 In recent years, DSS has reduced its overall person-year budget by 800; approximately half falls within the scope of this audit. It has also implemented new policies and is developing a number of initiatives, all of which should contribute to lower product costs in future. There remains a major challenge for management to improve productivity further.

11.109 To improve productivity while maintaining the current product quality, the Department of Supply and Services should:

- **set cost and quality targets for all products in line with industry standards and develop the necessary plans for their achievement;**
- **establish clear and responsive accountability relationships for the cost and performance of each product under the new plan;**
- **ensure that appropriate human resource skills are put to use in developing and executing these plans;**
- **develop automated systems capable of achieving planned cost and quality targets;**
- **develop adequate information tools in the area of cost accounting and performance measurement systems to control and monitor the performance of each product line; and**
- **commit its resources to the successful and timely implementation of these plans.**

11.110 Achieving major productivity gains by exploiting fully the benefits of automation, while maintaining the current product quality, represents a major challenge for both human resources and automation management. Time, effort, and the support of the Treasury Board, the Office of the Comptroller General and DSS's client community will all be required to meet the challenge successfully. We believe that the potential for savings to the government warrants this time, effort and support.

> ***Department's response****: The Department notes that many of the conclusions and recommendations of the Auditor General are consistent with conclusions already reached by departmental management and reinforce the justification for initiatives already taken or now under way.*
>
> *DSS recognized several years ago that the Public Service Pay and Superannuation systems were old, expensive to operate and maintain, and did not take sufficient advantage of current and uniform technology. DSS also recognized that the most significant step to correct these deficiencies was to harmonize the various technologies being utilized. That initiative was taken in 1980-81 and will be completed this fall. The conversion to single technology has been a high priority for available development resources, and was a precondition for further development activity.*
>
> *A concept plan for a Public Service Compensation System (PSCS) has now been developed to take greater advantage of the new technology and to significantly reduce costs. Estimates of cost savings are still in the process of being finalized. This work already demonstrates that cost savings will not approach the estimates*

in the Auditor General's report. In the view of management, the Auditor General's examination did not take adequate account of the cost impact of environmental factors mentioned. These factors, in our view, make the federal system unique. Preliminary steps have already been taken to obtain the necessary approvals so that this development can proceed as expeditiously as possible.

The Department always has and will continue, unless instructed otherwise by the Treasury Board, to place primary emphasis on the importance of service to its clients; that is, ensuring that its payments and other services are delivered without interruption. Value for money and productivity are very important considerations that will receive more emphasis. However, in meeting the challenge for increased automation of complex systems DSS does not propose either to act with undue haste or to assume an unacceptable high risk of failure.

The Department is sensitive to the impact of automation on its work force, both as individuals in their personal careers, and collectively as a team that represents the most important resource in our ability to have cost-effective product delivery. The Department is very proud of recent productivity gains, but recognizes that any such gains are achievable only with the co-operation and support of its people. The Department recognizes that it will have to devote the necessary time and resources to address the human dimension. Of particular concern is the retraining of personnel and the dislocation associated with a nationwide network of offices.

With respect to cost accounting and performance measurement systems, the Auditor General's examination was performed during a time of major transition both in organization and technology. With the integration under one Deputy Minister of the Supply and Services organizations, the various systems were found to be different and deficient. The cost and performance measurement systems then in place were costly and labour intensive, and the work standards were outdated. In 1985, it was decided to discontinue these systems and develop new, more efficient systems that would be relevant to the new organizations. The new corporate cost accounting system will be in place for fiscal year 1988-89 and will allow products and processes to be costed across organization lines. A new Regional Operations Management Information System will be instituted 1 January 1988, to provide performance measurement comparisons of the various offices.

Of particular importance is a new planning process that has been instituted for the information products and services that the Department provides. Roles and responsibilities have been more clearly defined to ensure that the product strategies, delivery strategies and technical strategies are mutually supportive to the same ends.

A number of recent initiatives have been undertaken, in co-operation with user departments and central agencies, to ensure disciplined project management, productivity improvement and cost visibility. These include a new standardized project management system.

All these initiatives will allow for the provision of improved information to Parliament through a revised Operational Plan Framework and Part III of the Estimates. This work is being pursued in co-operation with the Treasury Board

Secretariat in response to the government policy of Increased Managerial Authority and Accountability.

The opportunities to deliver enhanced services and products more efficiently are now available. The efficiencies will also enable a shift of funding from maintenance to development so further improvements can be achieved within the restraint framework by which the government must conduct its activities. The Department is committed to seizing these opportunities in partnership with the relevant central agencies and user departments.

DEPARTMENT OF NATIONAL HEALTH AND WELFARE

DEPARTMENT OF NATIONAL HEALTH AND WELFARE

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12

DEPARTMENT OF NATIONAL HEALTH AND WELFARE

Introduction

12.1 This chapter reports on the results of our comprehensive audit of the health programs of the Department of National Health and Welfare. It also reports on the results of an examination of financial management and control in the Department, which was conducted as part of a government-wide study on this subject, reported in Chapter 4.

12.2 The results of other audit work conducted in the Department are discussed elsewhere in the Report. This work includes a follow-up of the 1985 Public Pension Management Audit (Chapter 16), a special audit of Emergency Preparedness (Chapter 15), and a major capital project audit – the Canada Olympic Park (also Chapter 15).

Description of the Department

12.3 The Department of National Health and Welfare is responsible for matters over which Parliament has jurisdiction related to the promotion and preservation of the health, social security and social welfare of the people of Canada. Departmental responsibilities include income security for individuals and families; essential social services, particularly for socially and economically disadvantaged Canadians; universal access for all Canadians to quality health services; protection against disease and environmental hazards; promotion of healthy lifestyles; promotion, encouragement and development of fitness and amateur sport; and support for the planning and staging of the XV Olympic Winter Games.

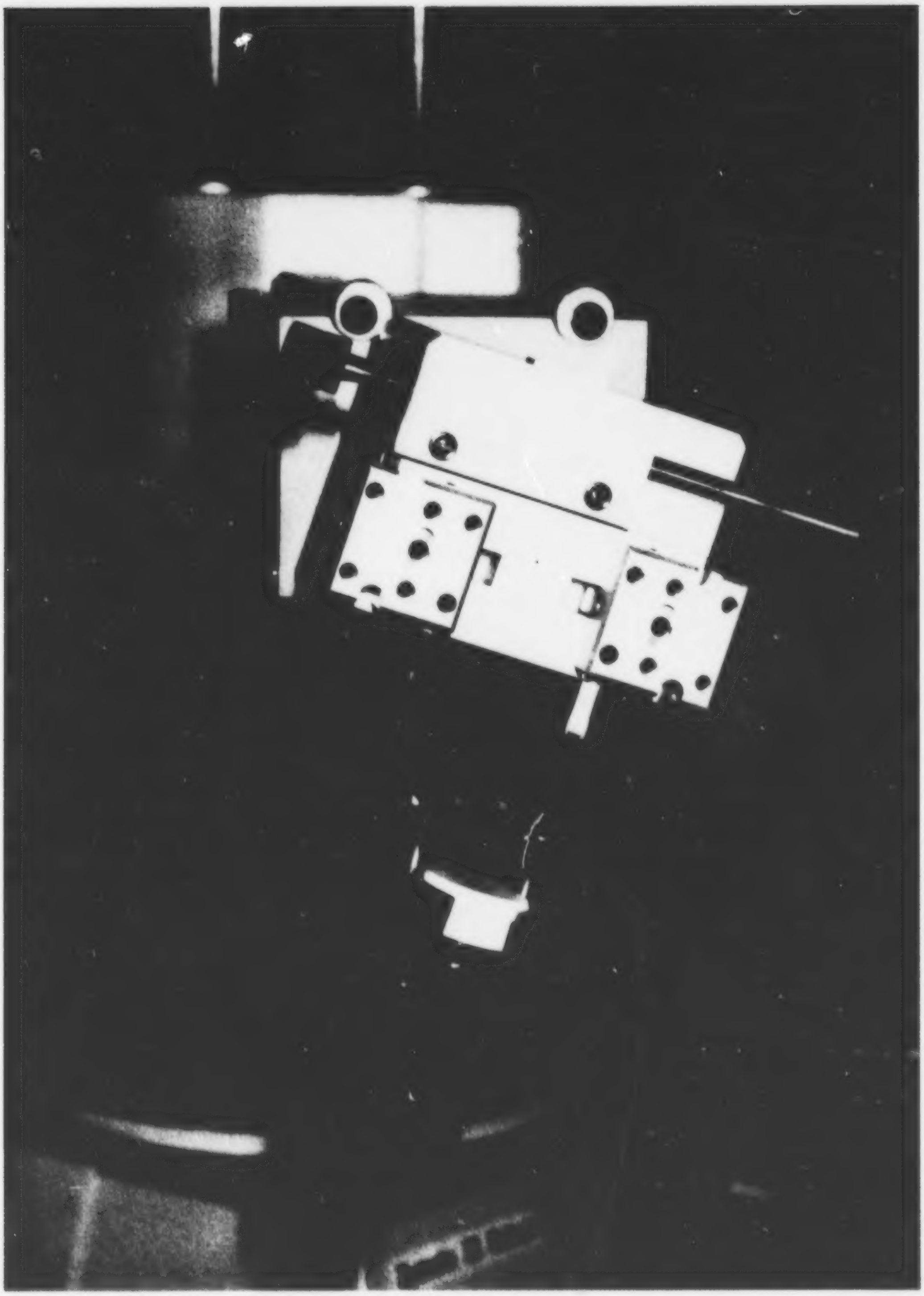
12.4 The Department has seven program branches and four administrative branches. The program branches have traditionally operated with a large degree of autonomy, partly because their operations are so diverse. Exhibit 12.1 shows National Health and Welfare's financial and human resources for 1986-87.

Health Programs

Audit Scope

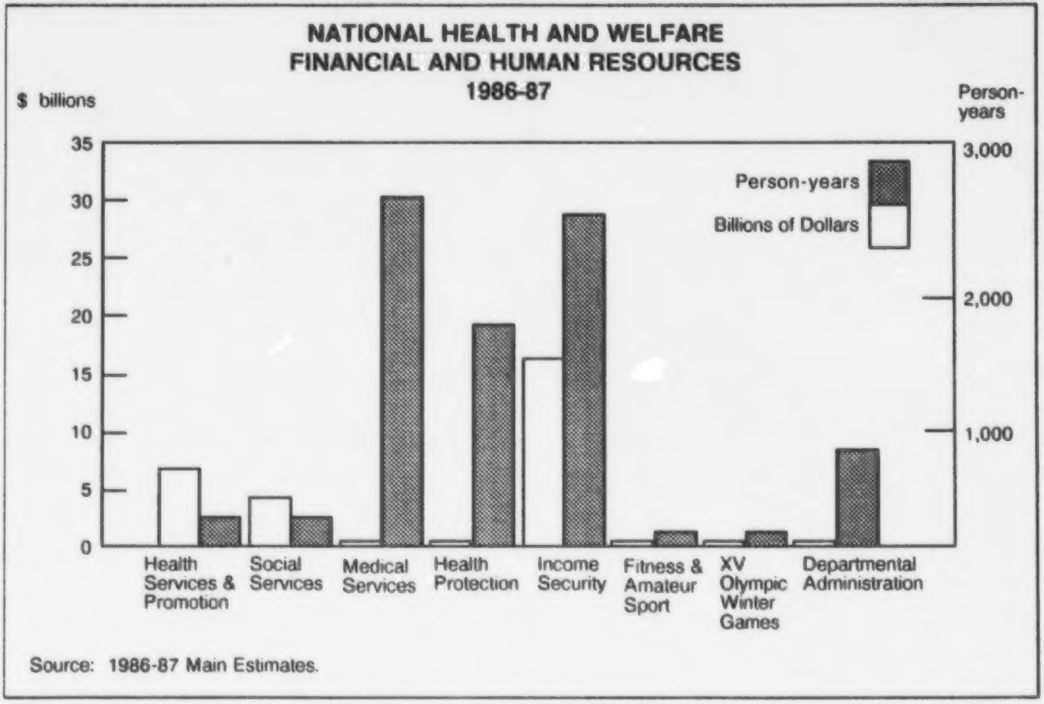
12.5 Our audit work focused on the management of the Department's major health programs. Exhibit 12.2 summarizes the full scope of our audit.

12.6 We have reported our detailed findings and observations on each program to the Department by way of project reports. The matters reported in this chapter are only those we consider to be of significance for Parliament.



Since 1986, the Department has used robots in its food testing laboratories. They can operate 24 hours a day and reduce operating costs (see paragraph 12.8).

Exhibit 12.1



NATIONAL HEALTH AND WELFARE
FINANCIAL AND HUMAN RESOURCES
1986-87

Source: 1986-87 Main Estimates.

Matters Being Brought to the Attention of Parliament

12.7 In many of the areas we looked at, the Department has good systems and procedures in place. For instance, the Health Services and Promotion Branch has well established procedures for the review, approval and monitoring of projects funded under its grants and contributions and other programs. Annual expenditures for these programs exceed $50 million.

12.8 There are other areas where improvement is needed, but we believe that, for the most part, appropriate action is being taken to address the situation. For example, the Department has recently taken steps to improve productivity in the food and drug plant inspection process. These steps include introducing robots to do routine laboratory analysis (see photo). Robots can operate 24 hours a day, thus reducing operating costs. The Department has also computerized other procedures for analysing drug products. This is resulting in a 25 per cent increase in efficiency in processing laboratory samples in certain areas. Although there is room for improving productivity further, such as through better use of inspection resources, the Department is taking reasonable steps to improve efficiency in this area.

12.9 We believe, however, that the following matters, which are discussed in greater detail in this chapter, should be brought to the attention of Parliament:

Exhibit 12.2

1987 Comprehensive Audit - Health Programs
Audit Scope

Program Activity	Health Protection Branch	Medical Services Branch	Health Services and Promotion Branch	Fitness Canada Directorate
Planning	X	X	X	X
Information Systems	X	X	X	
Program Delivery	Drug Regulation Food Regulation Medical Devices Regulation AIDS Program	Indian and Northern Health	Health Insurance Health Services Health Promotion Extramural Research Programs	Fitness Contributions
Financial Management and Control	X	X	X	X
Facilities	X	X		
Equipment & Supplies	X		X	
Cost Recovery		X		
Evaluation	X	X	X	X

- **Drug Regulation.** Despite significant external pressures, the Department's action to reduce delays in reviewing and approving drug submissions and clear the resulting backlogs has not yet been effective. These backlogs continue to increase at an alarming rate. They increased by 69 per cent from 1985 to 1986 alone. This problem is of major concern to the pharmaceutical industry. Also, there are inadequate procedures for monitoring adverse drug reactions and unapproved drugs released for emergency use. The result is that some Canadians may be facing unnecessary risk.

- **Indian and Northern Health Services.** The population served by this program is complex and diverse. This, together with the fact that government policy limits fully efficient delivery of some major services, makes Indian and Northern Health Services a difficult activity to manage and control. Despite internal and external recommendations to improve them, existing planning, evaluation and management information systems are so deficient that the Department cannot be sure that the delivery of health services to status Indian, Inuit and northern populations is adequate. The Department is also providing certain services, estimated to cost in excess of $40 million annually, which would normally be paid for by the provinces and territories. We also noted instances where health facilities were being built with excess capacity.

- **Health Insurance.** Annual transfer payments of some $7 billion are made subject to provincial health insurance plans operating in accordance with the requirements of the Canada Health Act. The Department needs to do a better job of monitoring and reporting on the extent of this compliance.

- **Fitness Canada.** The Department of National Health and Welfare has not demonstrated due regard for efficiency and effectiveness in delivering its $8 million fitness contribution program.

Drug Regulation

Background

12.10 The Department's Health Protection Branch is responsible for identifying and controlling health hazards associated with food, drugs, medical devices, radiation emitting devices, and the environment. It carries out four main types of activities: research and analysis to identify and assess health hazards; pre-market review and approval of products; setting standards and regulations for control; and post-market monitoring and enforcement.

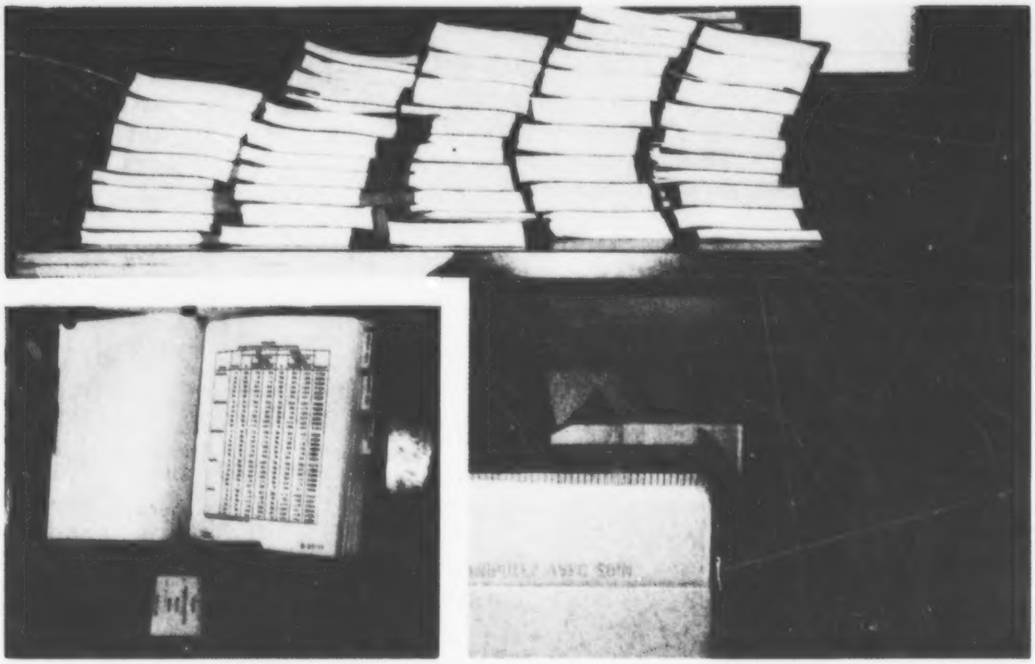
12.11 One of the major responsibilities of the Health Protection Branch is administering the Food and Drugs Act. Under this Act, the Branch is responsible for regulating food, drugs and medical devices for use in Canada.

12.12 During 1986-87, the Branch spent $135 million and had some 1,900 person-years. The annual workload of the Branch includes processing over 2,500 submissions for drugs, food additives and new medical devices, inspecting some 240 drug manufacturing plants and more than 2,000 food plants, analysing samples of 15,000 marketed drug products, and carrying out 38,000 laboratory tests on 14,000 food samples.

12.13 In all three areas – food, drugs, and medical devices – we found that there were serious delays and backlogs in reviewing and approving submissions for new products and that regulatory time requirements for processing them were not being met. This was due in part to unrealistic time frames. It was also due to increasing workloads and inefficient management practices. In all three areas, improvements were under way. In both the food and medical devices areas, these actions were beginning to result in reductions in backlogs and turnaround times. However, management actions were not having a similar effect in the drug area; in fact, delays and backlogs were increasing at an alarming rate.

Audit Scope

12.14 We examined the process for reviewing and approving new drug submissions, as well as initiatives taken to improve it. We also reviewed how the Department manages the Emergency Drug Release Program. Finally, we examined the information management uses to monitor adverse reactions to approved drug products and looked at how drug manufacturing plants are inspected.



This is one drug submission covering approximately 125 volumes (see paragraph 12.17).

Approving New Drug Submissions

12.15 Under the Food and Drugs Act, the Department of National Health and Welfare is charged with reviewing submissions by drug manufacturers regarding new drug products proposed for marketing in Canada. These products include innovator drugs, which are entirely new products not previously marketed in Canada, and generic drugs, which are copies of approved drug products. Approval takes the form of a Notice of Compliance issued by the Department.

12.16 **Delays in approving drug submissions**. The Department processes three main types of drug submissions:

- Investigational New Drug Submission - to obtain approval for controlled tests prior to carrying out clinical trials on a new drug product. A new drug submission would follow upon completion of these tests.
- New Drug Submission - to obtain permission to market a drug product in Canada.
- Supplemental New Drug Submission - to make changes to an approved drug product.

12.17 The Food and Drugs Regulations set minimum requirements for material to be submitted with a new drug submission. A submission contains detailed and complex data – on the chemistry and manufacturing of the drug product, the results of animal safety studies, and the results of all clinical tests that have been carried out anywhere in the world. An average submission comes in as many as 100 volumes of binders, each about 3 inches thick (see photo).

12.18 The Regulations provided that the Department must respond to a new drug submission within 120 days, either granting a Notice of Compliance or providing reasons to prevent marketing.

12.19 The Department has not been able to comply with this requirement for over five years. At the time of our audit, the average time to respond to a new drug submission was about 350 days. Early in 1984, failure to meet the 120-day provision was challenged successfully in the courts by a drug manufacturing firm, forcing the Department to give priority to reviewing the firm's submission. To avoid further legal challenges, the government suspended the 120-day provision until October 1986. Because the Department was still unable to meet the deadline, the suspension has now been extended until December 1987. No new time frame has been established.

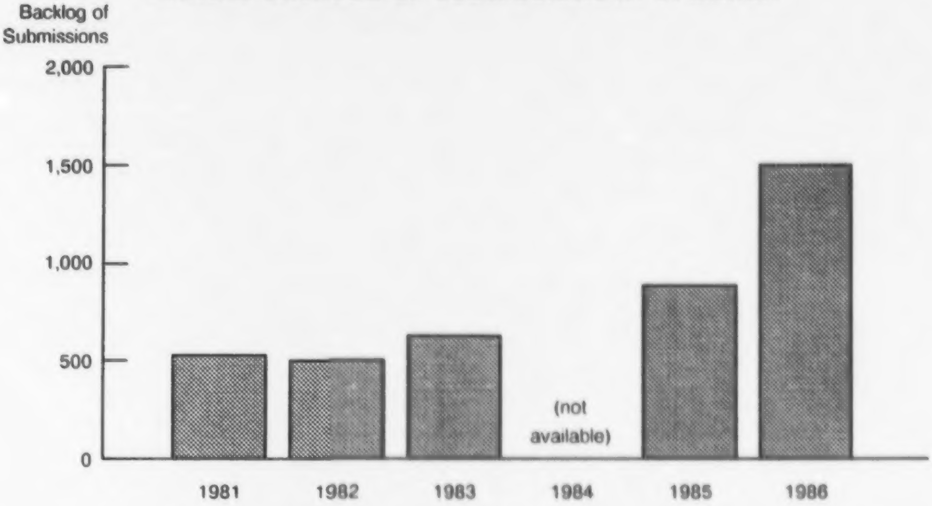
12.20 Delays in processing drug submissions have been recognized and pointed out by the 1985 Eastman Commission of Inquiry into the Pharmaceutical Industry and by the 1985 Ministerial Task Force on Program Review. In addition, at the time of our audit, a ministerial task force was examining ways of speeding up the process.

12.21 The Department has undertaken a number of initiatives. They included adding some 20 person-years to the drug submission review process (an increase of 18 per cent) and requiring the submission of certified summaries by drug manufacturers to improve the speed of their review. The Department established a target turnaround time of 60 days for investigational new drug submissions (the legislative time requirements apply only to new drug submissions, not to the investigational submissions). In addition, several organizational changes were being proposed.

12.22 These management actions have not yet begun to resolve the problem. Considerable delays persist, and the backlog in drug submissions awaiting approval is increasing. For example, the clearance time for new human prescription drug submissions by drug manufacturers increased from 555 days in 1984-85 to 735 days in 1985-86, an increase of 32 per cent. The backlog in these submissions increased from 532 in 1981 to 1,512 in 1986 – an increase of 184 per cent (see Exhibit 12.3). Similarly, the average length of time to clear an investigational new drug submission in 1985-86 was 130 days, up 24 days from the year before, and more than double its target turnaround time.

Exhibit 12.3

BUREAU OF HUMAN PRESCRIPTION DRUGS
ANNUAL BACKLOG OF SUBMISSIONS AT 31 MARCH



Backlog of submissions for human prescription drugs has increased at an average annual rate of 35 per cent from 1981 to 1986 and by 69 per cent from 1985 to 1986.

Source: Departmental records.

12.23 The Department attributes these delays and backlogs to resource limitations and an increasing annual workload – the number of submissions received is increasing at an annual rate of 8 per cent. In fact, its current work plans are based on the assumption that backlogs will continue to increase.

12.24 In our opinion, the increasing backlogs and delays in clearing drug submissions will remain out of control unless the Department takes additional action to address the situation. We believe that there is room to improve the management of the drug submission review process and to handle submissions faster, for example, by:

- Establishing productivity targets and completion dates. The backlog is made up largely of submissions awaiting their first review. Normally, each submission is subject to two different evaluations – pharmaceutical (including manufacturing and chemical) and clinical (including medical and biological) – by four different reviewers who examine submissions on a first come, first served basis. Each reviewer's workload can include several types of submissions. There is no mechanism to co-ordinate these reviews, with the result that the various evaluations related to a single submission are completed at different times and no submissions can be approved until the last evaluation has been completed. Also, there are no targets set for the length of time it should take to do an evaluation.

- Ensuring better quality submissions. Reviewers find that the information in most submissions is insufficient or inadequate. Management estimates that over 90 per cent of all submissions require clarification or additional documentation. The reasons for the poor quality of submissions have not been fully investigated and addressed. For example, at the time of our audit, the Department had not issued guidelines on preparing submissions for generic drug manufacturers, despite the fact that information requirements for their submissions appear to differ from those for manufacturers of innovator drugs.

- Assessing the adequacy of professional training programs. There is no formal internal training program for professional staff, and resources for outside training and development have been limited. Most individuals we interviewed stressed the need to keep abreast of technological advances in drug development.

- Considering alternative approaches for carrying out each step in the drug submission clearance process. Alternatives could include computerization of submissions and storage of information, contracting out first reviews, and using outside expert advisers to increase industry confidence in the process.

- Establishing a more independent and objective appeals process. When a company receives an unfavourable decision on its submission, its recourse is to re-submit the information to a higher authority in the Department. However, this second review is conducted by the same reviewer who recommended the original decision. As a result, there is no mechanism to ensure the objectivity of the review and of the decisions taken as a result of it.

12.25 **The Department of National and Health and Welfare should take action to reduce the backlog in clearing drug submissions and improve the process for reviewing and approving drug submissions by:**

- **setting productivity targets and completion dates for clearing submissions;**

- **investigating ways, including issuing guidelines, to ensure that drug manufacturers submit more complete and better quality information;**

- **assessing the adequacy of professional development programs for its staff;**

- **considering ways of streamlining the review and approval process, such as computerizing some of the work, contracting out first reviews and using outside expert advisers; and**

- **establishing a more independent and objective appeals process.**

***Department's response**: Due to the varying size and complexity of submissions, it is difficult to establish productivity targets and completion dates for submissions as they are assigned to reviewers. Submissions range from one to many hundreds of volumes, from relatively known to completely new chemical and therapeutic entities. Line managers assign review work based on their assessment of clinical and pharmaceutical expertise, and constantly monitor review progress, with the Clinical managers co-ordinating the clinical and pharmaceutical aspects of review.*

Through industry liaison and the publication of format and content guidelines, the Department has greatly improved the quality of submissions received from manufacturers. The need for additional data to submissions is a measure of the complexity of the subject matter, and not merely an indication of submission quality. Guidelines have been published which establish requirements for submissions from all manufacturers. The amount of information in these dossiers depends on how much is known about the drug's action. For an entirely new chemical entity, very little information is in the public domain. For an existing drug, the amount of information required for a submission will depend on the time since first introduction. The Department feels that the audit team statements reflect a misunderstanding of the nature and content of drug submissions.

The Department would be pleased to increase professional development activities, but does not have sufficient resources to allocate additional funds to this area.

The Department has considered and continues to review and propose improvements to the submission clearance process. To date, no acceptable alternative has been found which balances the protection of the health of Canadians, the fulfillment of statutory obligations and the increasing of efficiency.

The Department has an existing administrative procedure which permits appeal of decisions to increasingly higher levels of management review. In addition, the procedure permits expert consultants from all parties to be solicited for opinions. The Department is proposing to formalize this process.

In summary, the Department uses the best available management techniques through its line managers to monitor and control productivity and review output. The Department has published and continues to publish guidelines to assist those preparing submissions. The Department allocates resources to professional development programs as much as possible. The Department has considered and continues to review and propose improvements to the submission clearance process. The Department has proposed the formalization of the currently existing appeals vehicle.

Emergency Drug Releases

12.26 The legislation provides that new drugs waiting for approval may be released for use on an emergency basis. This release is conditional on the physician reporting to the manufacturer and the Department on the results of the use of the drug in the medical emergency.

12.27 The number of emergency drug releases authorized has increased significantly in recent years, from 1,204 in 1978-79 to 9,903 in 1985-86. This increase in requests is due, in part, to the lengthy delays in approving new drug product submissions.

12.28 The Department has not established an adequate system for monitoring and reporting the results of the use of drug products released on an emergency basis. Despite the legislative requirement, only about 30 per cent of the releases authorized by the Department result in verbal or written feedback from physicians. Moreover, the Department does not systematically ensure that the results of the feedback it does receive are analysed or used in reviewing and approving the drug product for general release. As a result, the Department does not benefit fully from the available information on these drug products in clearing their pending submissions.

12.29 The Department of National and Health and Welfare should establish a system for collecting, analysing and using information on the safety and effectiveness of drug products released on an emergency basis.

> ***Department's response:*** *The Department is of the opinion that the imposition of substantial reporting obligations on physicians would be counter-productive and costly, and could impair the effective delivery of health care. Through voluntary reporting, physicians currently highlight the more important or significant experiences. The Department has proposed that industry involvement in the administrative process related to Emergency Drug Release be increased, but support of this proposal by industry has not been forthcoming to date, due to resource implications.*

Monitoring Adverse Drug Reactions

12.30 The Department does not have an adequate system for monitoring adverse reactions caused by the use of drug products it has approved for marketing in Canada. The result is that some Canadians may be facing unnecessary risk.

12.31 The Food and Drugs Regulations require drug manufacturers to report adverse reactions caused by drugs that have been approved for marketing. The Drugs Directorate of the Health Protection Branch is responsible for receiving this information. Another Branch directorate, the Laboratory Centre for Disease Control (LCDC), receives similar information provided voluntarily by physicians, pharmacists and hospitals.

12.32 There are no procedures to ensure that drug manufacturers are complying with legislative requirements and reporting all adverse drug reactions as they should. The Department carries out no independent checks on manufacturers to ensure that the system is working properly. There is also room to improve the voluntary reporting of adverse drug reaction information. One children's hospital we visited had a detailed system for reporting adverse drug reactions to the provincial medical association. The Department has a contractual arrangement with the association to provide adverse drug reaction information. However, the Department has decided to terminate the contract at the end of 1987-88. This will limit voluntary reporting.

12.33 Moreover, we found that instead of the two directorates consolidating information and analysing the magnitude of and trends in suspected adverse drug reaction problems, each analyses its own information. Also, there is no evidence to indicate that the Department uses the information systematically to monitor the safety of the drugs it has approved.

The Department's manual system for storage of adverse drug reaction information (see paragraph 12.34).

12.34 The system for filing and analysing data is primarily manual, resulting in untimely analysis and reports. For instance, information received by LCDC is manually sorted and stored in pigeon holes (see photo).

12.35 At the time of our audit, the Department had initiated action to establish a national surveillance system for adverse reactions to vaccines. It had also begun to computerize the processing of information. But there is much more to be done.

12.36 **The Department of National Health and Welfare should take steps to:**

- **improve reporting of adverse drug reactions by drug manufacturers, physicians, pharmacists and hospitals;**
- **co-ordinate and consolidate the information it receives on adverse drug reactions, whether that information is submitted to comply with regulatory requirements or on a voluntary basis; and**
- **analyse and use the adverse drug reaction information to monitor and control the safety of all drug products marketed in Canada.**

Department's response: *The Department has improved the utilization of information on adverse drug reactions. The mature, funded program in Ontario is moving to a non-funded format, with increased initiatives being put in place* *in other provinces. Linkages have been established within the Department which warn of significant or serious cases, with appropriate sharing of information when needed.*

Drug Plant Inspections

12.37 We examined the procedures used by the Department to inspect drug plants and consider them generally satisfactory. The Department has been systematic in identifying and assigning priorities to health risks and using this information to plan and carry out the inspection activities.

Indian and Northern Health Services

Background

12.38 The federal government provides health services to status Indians and Inuit living in all provinces and to all residents of the Yukon and the Northwest Territories. Services provided include public health care programs, active treatment services, health promotion, preventive health programs, environmental health services on reserves, and programs involving Indians in their own health care. The total population served exceeds 400,000. These activities involve 2,400 person-years. In 1986-87, the operating budget was $417 million.

12.39 Delivering these services is complex. Contributing to the complexity are geographic dispersion and isolation of the population, the variety of Indian and Inuit cultures, languages and needs, and fragmentation of jurisdiction over the provision of health care and responsibility for these people.

12.40 In 1979, the federal government adopted the Indian Health Policy. It is aimed at improving the quality of community life, raising the level of health of Indians and Inuit to that of other Canadians, and increasing participation by Indians and Inuit in their own health care programs. Its stated goal is "to achieve an increasing level of health in Indian communities, generated and maintained by the Indian communities themselves".

Audit Scope

12.41 We examined how the Department of National Health and Welfare planned its Indian and Northern Health Services activities and allocated resources to them, how it managed its operations, and how it measured, reported and used information on how well it accomplished program objectives. We also examined how the Department was managing the transfer of health care programs to Indian communities in the south and to territorial governments in the north.

Assessing Health Care Needs

12.42 During our 1982 comprehensive audit of this activity, we excluded planning, evaluation and performance measurement systems from the audit because they were just being established. Five years later, and given the importance government is placing on better management and accountability, we were expecting to see significant improvements in all these areas.

12.43 This has not happened, despite substantial efforts on the part of management. In fact, existing planning, evaluation and management information systems are so deficient that the Department cannot be sure that it is providing an adequate level of health care and that it is doing so with due regard to economy, efficiency and effectiveness.

12.44 **Planning.** Although one of the principal goals of the Indian Health Policy is to have Indian communities more involved in managing their own health care programs, there is no integrated approach to health planning on a community basis. Program decisions are made by individual program officers in many places – zones, regions, headquarters, hospitals, universities and within program advisory groups such as the National Native Alcohol and Drug Program. These decisions are not co-ordinated.

12.45 Operational plans do not link resources with results. For instance, the Department's Operational Plan Framework contains no reference to non-insured health benefits, although they represent 40 per cent of Indian and Northern Health Services costs. Also, work plans are not linked to operational plans and little use is made of them.

12.46 **Management information systems.** For the most part, the Department's efforts to implement comprehensive and useful management information systems have not been successful. For example, in 1977, a nurse activity reporting system, designed to cover some 550 individuals, was introduced. Ten years later, and despite the fact that it is considered to provide useful information, the system has been implemented in only 6 of the 10 regions.

12.47 We also found that data collected at the region and zone level are often not analysed or used and that the reliability and accuracy of some are questionable. In one instance, the Sioux Lookout Zone entered into a contract with an outside firm to produce monthly operations information. The total cost of the contract for 1986-87 was $41,500. When we visited the zone in November 1986, the monthly reports for January 1986 had just been received. The information was not complete, and it was not clear who was using the reports and hence why the data were being collected.

12.48 **Evaluation.** The lack of adequate measurement systems has hindered evaluation of the Indian and Northern Health Services activity. At the time of our audit, significant portions of this activity had not yet been evaluated. An evaluation of the National Native Alcohol and Drug Abuse Program, which has been under way for over 10 years, was recently postponed indefinitely because of lack of adequate data. The major component of the activity, non-insured health benefits, had not been scheduled for evaluation.

12.49 The Department of National Health and Welfare should make concerted efforts to implement adequate planning, evaluation and information systems for delivering health services to the status Indian, Inuit and northern populations of Canada so that it can properly plan for and assess whether it is meeting its objective of raising their level of health to that of other Canadians.

> ***Department's response:***
>
> ***Planning:*** *The need to implement improved planning, information and measurement systems to better assess the adequacy of Health Services to native people has been recognized. Initiatives are already under way to develop community based information, to improve the link between resources and operating results and the use of planning documents in the decision-making process in the Branch.*
>
> ***Management Information Systems:*** *The informatics function has recently been consolidated at the departmental level to improve effectiveness in developing management information systems. A Branch informatics co-ordinator has been appointed to ensure priority systems are adequately funded and properly implemented.*
>
> ***Evaluation:*** *An evaluation of the Indian Health Services activity is currently being planned for completion in 1989-90. An evaluation on the Northern Health Services Program has been completed.*

Health Care Delivery

12.50 **Health aides and professionals.** Health services are delivered by a wide range of personnel including doctors, nurses and other health professionals. Services are also provided by community health aides, such as community health representatives, health liaison workers and lay dispensers. These persons, numbering over 3,000, work under a variety of arrangements. Some are employees, some are hired under contract, others work under contribution agreements.

12.51 In general, they are well regarded by the population they serve and are considered to play an important role in maintaining the well-being of the community (see photo).

12.52 **Non-insured health benefits.** Non-insured health benefits are health-related goods and services provided by the Department to status Indians and to Inuit. These benefits include patient transportation, prescription drugs, eye glasses, and dental services. For the most part, they are not covered by provincial health insurance plans. The Department also pays for those benefits where these people are excluded from coverage under these health plans.

12.53 Prior to 1979, these benefits were provided on the basis of a needs test to status Indians living on reserves and to Inuit. The introduction of the 1979 Indian Health Policy had

Health aides and professionals play an important role in maintaining the well-being of the communities they serve (see paragraphs 12.50, 12.51).

the effect of extending non-insured health services to status Indians and Inuit, regardless of ability to pay or place of residence.

12.54 Removing needs testing and extending coverage to off-reserve Indians has contributed to a rapid escalation in expenditures. Costs rose from $36 million in 1979-80 to $166 million in 1986-87. During the same period, these expenditures rose as a percentage of total Indian and Northern Health Services costs from 26 per cent to 40 per cent.

12.55 Based on information provided by the Department, we estimate that this change in policy has resulted in additional costs of $300 million for non-insured services over the last seven years.

12.56 Since 1980, several alternatives have been presented to Treasury Board and Cabinet to deal with the situation, including re-introducing needs testing. To date, the policy has not been changed.

12.57 Over the past several years, the Department has taken several important steps to improve the delivery of its operations, particularly in view of the increasing volume of transactions. These steps include developing health care standards and initiating a process to contract out dental claims processing on a national basis.

12.58 However, as discussed earlier, because planning and evaluation processes are poor and there is very little in the way of performance measures, the Department is not able to assess adequately how effectively these non-insured benefits have contributed to maintaining or improving the health of these people.

12.59 Several other areas also require improvement. They include clarifying the respective roles and responsibilities of the provinces and the federal government in delivering these health care services and providing better information to Parliament.

12.60 *Roles and responsibilities*. Some provinces and territories provide certain non-insured benefits to the general population, but exclude status Indians and Inuit. In these instances, the Department of National Health and Welfare pays for these services. For example, these people are excluded from the Saskatchewan drug plan and from the patient transportation program in the Northwest Territories.

12.61 The provision of these services to status Indians and Inuit has been a matter of government policy since 1945 and was reaffirmed in the 1979 Indian Health Policy.

12.62 Generally, to qualify for benefits under provincial programs, a person must be a resident of the province and be a member of a class for which the plan was designed (over 65 years of age or persons requiring social assistance, for example). There appears to be no basis in law, however, for provincial and territorial governments to exclude status Indians and Inuit from coverage under their health programs if they meet eligibility requirements.

12.63 Thus, the federal government may be absorbing millions of dollars each year for health care costs that should be borne by the provinces and territories. The Department has never estimated how much it absorbs because of these exclusions from provincial health schemes. We estimate that the cost exceeds $40 million a year.

12.64 Further, the Department has not entered into formal discussions with the provinces and territories on their respective roles and responsibilities in this area.

12.65 *Information for Parliament.* The information provided to Parliament about non-insured health benefits is inadequate. Part III of the Estimates contains little information on this major expenditure. Without complete and meaningful information on cost characteristics, trends and achievements, Members of Parliament have no way of assessing and understanding the financial implications of providing these health benefits.

12.66 In addition, some of the information provided to Parliament is misleading. For instance, the 1987-88 Estimates refer to a decrease of $15 million in expenditures on non-insured health benefits between 1986-87 and 1987-88. In fact, based on departmental estimates, there will likely be an increase of $30 million. The fact that a significant amount of these expenditures is funded through supplementary estimates each year is not disclosed.

12.67 **The Department of National Health and Welfare should:**

- **reach agreement with those provinces and territories that provide non-insured benefits to the general population on respective federal and provincial/territorial responsibilities for providing these benefits to status Indians and Inuit and on the financial burden each government will assume; and**
- **significantly improve the reporting of information on these benefits to Parliament.**

Department's response: *The Department is pursuing initiatives to strengthen the administration of Non-Insured Health Benefits and is discussing possible policy options with the Minister.*

A central co-ordinating function for Non-Insured Health Benefits has been established at Headquarters with responsibility for providing guidance and direction to regional managers.

The Department will re-assess the information contained in Part III of the Estimates with the view to improving reporting on Non-Insured Health Benefits.

12.68 **National Native Alcohol and Drug Abuse Program.** The objective of this contribution program is to reduce alcohol and drug abuse in Indian and Inuit communities. It began as a pilot project in 1975 and became a permanent program in 1982. Contributions are given to communities for prevention programs, in-patient and out-patient treatment services, training of prevention and treatment workers, construction of treatment facilities, and research and development. Total expenditures increased from $16 million in 1982-83 to $48 million in 1986-87.

12.69 Departmental management considers the National Native Alcohol and Drug Abuse Program vital in improving the health of Indian and Inuit people. In addition, the published documents, including the Estimates, lead readers to believe that the program has been quite successful. In fact, however, we found that the Department has little information with which to gauge the success of the Program's activities.

12.70 There are no performance measures, and little information on drug and alcohol abuse in the communities is collected. Efforts have been under way since 1981 to develop and implement management information systems; these have not been successful, however, despite Treasury Board requests and departmental agreements.

12.71 There are no documented criteria and procedures to guide those responsible for approving contribution agreements with bands and communities. There is no requirement that agreements contain statements of intended purpose, activities and results. Recipients are required to submit quarterly status reports, but these are not always submitted. Moreover, in some cases, we could not determine what, if any, analysis was being done on the reports that were received. Finally, because regions do not report detailed expenditure information to headquarters, senior management did not know how resources were being spent.

12.72 Three of the four implementation goals approved by Cabinet for the continued funding of the program have not been met. For example, as of 31 March 1987, only 500 beds in 24 treatment centres had been built. This is only two-thirds of the original target. The Department told us that for the first few years after the National Native Alcohol and Drug Abuse Program became permanent, funds destined for capital contributions were not spent as planned because of a lack of requests from Indian and Inuit groups, the time needed to carry out feasibility studies, and the lack of procedures and design guidelines. These guidelines and procedures are now in place, and current capital budgets ($7 million) are fully committed.

12.73 Another one of the Program's implementation goals was to train some 800 native alcohol/drug abuse workers. In fact, some 900 persons have been trained, but there is high turnover among these workers – the Branch estimates 20 per cent per year. However, there is no process to identify replacement workers or to provide training for them. Although the implementation goal was achieved, a significant number of workers currently employed under contribution agreements may have had little or no training in alcohol/drug abuse problems.

12.74 Each year about $1.5 million is allocated for research and development, one of the Program's five activities. However, this portion of the budget is continually lapsing. The Department was unable to provide us with reasons why.

12.75 There have been several efforts over the last 10 years to evaluate the Program. Most recently, in 1985, Treasury Board requested an evaluation of the Program by October 1986. In March 1987, the Department completed an evaluation plan that concluded it was not possible to carry out a useful evaluation because of inadequate data. It recommended the implementation of meaningful information systems. In spite of this and the fact that not all the Program's implementation goals have been met, Treasury Board is continuing to approve funding of the Program.

12.76 The Department of National Health and Welfare should take steps to improve the management and delivery of the National Native Alcohol and Drug Abuse Program. These steps should include:

- **collecting and analysing data on alcohol and drug abuse problems;**
- **improving financial management and controls over the review, approval and monitoring of contribution agreements and the reporting of expenditures;**
- **assessing the adequacy of existing training programs for alcohol/drug abuse workers; and**
- **establishing procedures for measuring and reporting on the effectiveness of the Program.**

Department's response: *The lack of fully developed management information systems has been recognized by the Department. To correct this situation, Treasury Activity Reporting Systems and Prevention Activity Reporting Systems have been developed through an extensive consultative process and have been field tested in six of NNADAP's operational treatment centres and twenty community prevention projects. Final systems modifications are anticipated as a result of this process and full implementation is expected in 1988.*

As well, a planning information system has been implemented. It generates data on the growth and maintenance of the NNADAP infrastructure in terms of project funding levels, staffing and program coverage.

The Department also recognizes the need to fully evaluate the effectiveness of the program.

12.77 **Health facilities**. The Department operates some 500 health facilities across Canada. Over the past 15 years there has been a trend away from building hospitals in central locations to constructing smaller facilities in more remote areas designed to serve specific communities.

12.78 *Hospitals*. The Department operates eight hospitals. Most were built in the early 1950s as tuberculosis hospitals. Today, they are used as general purpose hospitals and serve all the surrounding population. Total annual operating costs are about $35 million.

12.79 The Department estimates that four of the hospitals are in an advanced state of deterioration and require major physical changes or replacement. Moreover, occupancy rates in seven of the eight hospitals are very low, ranging from 43 per cent to 51 per cent.

12.80 Over the past several years, the Department has been actively seeking alternative ways of providing hospital services to these populations. However, because of strong pressures from Indian communities not to close these facilities, as well as difficulties in negotiating transfers of the hospitals, the Branch has found itself in the position of having to operate the hospitals even though certain of the services are no longer needed or can be obtained elsewhere.

12.81 *Capital planning process*. Since the early 1980s, the Department has incurred significant expenditures for new health facilities, including health centres, nursing stations and health stations. Total expenditures amounted to $25 million for 1986-87. They are expected to exceed $25 million for each of the next three years. Because of these substantial capital outlays, we examined the planning undertaken for the construction of new health facilities.

12.82 In 1985, the Medical Services Branch established a capital program policy. However, decisions related to the construction of the new facilities are not being made in accordance with this policy. Also given the significant amount of capital construction that has gone on over the past six years and the precedents that this has created, it may be difficult in future for the Department to comply with some of the policy guidelines.

12.83 The policy states that health facilities are to be provided and maintained according to the extent and nature of health services for the community and on the basis of its population size and degree of isolation. Need is to be determined through community-based assessments, and analysis of health service delivery options is mandatory so as to ensure that the most efficient and effective delivery option is selected. We found that:

- The quality of needs assessments varied considerably, and many did not meet policy requirements. None of the eight assessments we examined fully met the requirements.
- Alternative health service delivery options (for example, on-site versus referral) were not considered.
- The need to construct treatment facilities was not always being considered in connection with community health and other needs.
- The decision to build nursing station facilities is based primarily on a population criterion of 400. This number evolved from a 1969 study and has not been updated to reflect environmental and technological changes.

12.84 We also found that decisions are not supported by adequate cost information, and we noted instances where the Department was giving approval despite management concerns that the facilities would be too large.

12.85 An example of this is the nursing station in Cat Lake in Northern Ontario. It was completed in January 1987 at a cost of $1.6 million. The layout of this facility, which serves a population of 390, is almost identical to one proposed for another community that serves a population of 950. The other facility has an average workload of 30 visits per day – more than three times that of Cat Lake (8 visits per day). Branch management approved the Cat Lake project despite concerns that the facility would be underused for many years. We found no cost-benefit analysis to support the need for building this much capacity at Cat Lake at this time.

12.86 The overcapacity built into the Cat Lake facility is not an isolated instance. Nursing stations of the same size have recently been built in three other communities in Northern Ontario with populations of similar size. A recent internal audit report also identified overcapacity in facilities in Alberta.

12.87 **The Department of National Health and Welfare should evaluate the administration of its capital program for providing health facilities for status Indian, Inuit and northern populations with a view to ensuring that future facilities are built with due regard for economy.**

> ***Department's response**: The Department is in the process of conducting an evaluation on the Capital Planning Process. A Capital Review Task Force has been established to develop approval criteria for capital projects. To date, the Task Force has put in place updated facility definitions, space standards and standard construction costs within an overall Capital Accountability Framework.*

Transfer of Responsibility

12.88 In late 1985, the Department became actively involved in establishing ways and means to transfer responsibility for the delivery of health services to Indian communities in the south and to the territorial governments in the north. An organization with responsibility for effecting the transfer is in place and operating. Health delivery services in the Baffin Zone were transferred to the Government of the Northwest Territories in August 1986, and by May 1987, over 40 Pre-transfer Planning Agreements, covering 256 Indian bands, had been signed. However, the Department expects that the transfer process, especially to the Indian communities, will be a lengthy one.

12.89 Detailed guidelines and procedures still have to be worked out, and the specifics of which responsibilities are to be transferred have yet to be finalized. Moreover, until it implements better planning and evaluation systems and has better information about the level of health care in each community, the Department will be at a disadvantage in helping Indian people to prepare appropriate community health development plans and in negotiating the transfer in the most equitable way.

> ***Department's response**: A basic requirement for transfer is the preparation of a community health plan describing health priorities, program objectives, delivery mechanisms and budget. Specific provisions in the transfer agreement will also require information collection for annual financial audits and performance reports for mandatory programs, as well as program and health indicators to enable future evaluations.*

Health Insurance

Background

12.90 The federal government contributes almost $7 billion a year in cash payments to the provinces and territories for insured health services and extended health care services. These contributions are subject to the terms and conditions of the Canada Health Act. Another $5 billion is transferred through the tax system.

12.91 The Department of National Health and Welfare is responsible for making the payments and assessing whether provinces and territories are complying with the requirements of the Act. The Minister must report to Parliament annually on the extent of this compliance.

12.92 The Act specifies five criteria and two conditions that health care insurance plans are required to meet. The criteria cover public administration, comprehensiveness, universality, portability and accessibility. The conditions require the provinces to provide information the Department needs to administer the Act and to give recognition to federal contributions in public documents or advertising related to insured health services.

12.93 The Act also provides for deductions from contribution payments if any of the five criteria or two conditions are not met. These deductions are not mandatory but are to be determined by the Minister after full consultation with the provinces and territories involved.

12.94 In addition, the Act provides for mandatory deductions from payments to provinces that permit extra-billing by doctors or user fees for hospital or other health services. This provision has been effective in eliminating these practices in all provinces.

Audit Scope

12.95 In carrying out our audit, we looked at the procedures the Department has established for defining and monitoring compliance with the Canada Health Act and taking action on instances of non-compliance. We also examined how it reports to Parliament on the extent of compliance with the Act by the provinces and territories.

Defining Compliance

12.96 The Department uses the Act, supplemented by a 1985 letter of understanding from the Minister to the provinces and territories, as the basis for defining each criterion and condition. In our opinion, most of these terms have been clearly defined.

Monitoring Compliance

12.97 In monitoring compliance with the Act, we would expect departmental procedures to include reviewing provincial and territorial legislation to ensure it reflects federal requirements, reviewing and discussing with the provinces and territories the means by which they satisfy themselves that these requirements are complied with, and keeping abreast of current developments in the health field.

12.98 We found that the Department systematically monitors the extent to which the requirements of the Canada Health Act are provided for in provincial and territorial health care legislation. It performed a thorough compliance assessment of all legislation in 1984 when the Act was introduced, and it regularly monitors and assesses changes in the legislation. We also found that the Department has satisfactory procedures for reviewing current events in the health care field.

12.99 But the Department has no formal procedures to satisfy itself that health plans are being operated in accordance with provincial and territorial legislation, and thus that federal requirements are being met in practice. Its sources of information in this regard are discussions and correspondence with the provinces, review of provincial publications and news reports. The Department does not obtain explicit assurance, written or otherwise, from provinces and territories that their health systems are operating within their legislative framework. Without such assurance, the Department cannot adequately assess the extent of compliance with the Canada Health Act.

12.100 None of these monitoring procedures is documented, nor does the Department periodically document its overall assessment of provincial and territorial compliance. Moreover, it has not documented the uses that should be made of the data it collects.

Taking Action on Non-compliance

12.101 The Canada Health Act outlines procedures that should be followed in cases of non-compliance by a province or territory with any of the criteria or conditions. The first phase is consultation with the province or territory in question. The Department has to inform the province or territory by means of a written notice of concern; this is followed by consultation and a written report within 90 days. The second phase of the process is withholding cash contributions.

12.102 Cash contributions have been withheld with respect to extra-billing and user charges, but not with respect to non-compliance with any of the criteria or conditions. The Minister has written to his provincial counterparts about certain practices that do not or may not comply with the Act. In addition consultation is carried out at the official level.

12.103 However, the Department does not document its assessment of provincial legislation and practices that highlights areas of potential or actual non-compliance, what action has been taken and where things stand in the consultation process. The Department did prepare a comprehensive compliance assessment of provincial legislation in 1984. This assessment has not been updated using the results of subsequent consultations and provincial actions. However, management informed us that an update of this assessment is planned.

12.104 There is no documented timetable for resolving issues on non-compliance, and notices of concerns have not been issued to the provinces.

12.105 Instances of possible non-compliance identified include paying "home rates" rather than "host rates" for physician's services received out of the province, the lack of a dispute settlement process for determining reasonable compensation for physician services, and the failure to recognize the federal contribution to health insurance.

Reporting to Parliament

12.106 The Minister is required to report annually to Parliament on the extent to which the provinces have complied with the criteria and conditions in the Canada Health Act. Since the introduction of the Act, two annual reports (1984-85 and 1985-86) have been laid before Parliament. Neither report contained an assessment of compliance by the provinces.

12.107 The reports contain information compiled by the provinces and territories on the operation of their health care plans. The information is not consistent from one jurisdiction to another. We have seen no evidence to indicate that the Department assesses the completeness of the information it receives. It does not comment on provincial and territorial compliance with the Act.

12.108 By not assessing and reporting to Parliament on the extent of provincial compliance, the Minister is not discharging fully his responsibilities under the Canada Health Act. As a result, it is difficult for Parliament to determine whether billions of dollars in annual transfer payments are being made in accordance with the conditions it set in authorizing the transfers.

12.109 **The Department of National Health and Welfare should review and document procedures for monitoring compliance with the Canada Health Act. These procedures should include:**

- **reviewing provincial legislation to ensure it reflects federal requirements;**
- **reviewing the means by which provinces satisfy themselves that their respective legislative requirements are adhered to; and**
- **clearly defining how information collected for monitoring purposes should be used.**

12.110 **The Department of National Health and Welfare should assess the extent of provincial compliance with the criteria and conditions of the Canada Health Act. Where instances of non-compliance are identified, the Department should develop a timetable and action plan for resolving them in accordance with the procedures outlined in the Act.**

12.111 As required by the Canada Health Act, the Minister of National Health and Welfare should include in his annual report to Parliament on the administration of the Act, a specific statement on the extent to which provinces have complied with its criteria and conditions.

> ***Department's response**: The Department believes that the transfer of federal contributions to the provinces for health care is made with appropriate and sufficient safeguards. At the same time, it is recognized that there is a need for better documentation on the administration of the Canada Health Act and the monitoring of provincial compliance.*

Fitness Canada

Background

12.112 Fitness Canada is a directorate within the Department's Fitness and Amateur Sport Program Branch. Most of its program is delivered through contributions to national voluntary organizations, universities and arm's-length entities. Financial and technical support is provided for such things as fitness promotion, leadership development, demonstration projects, delivery of fitness programs and administration.

12.113 Total program expenditures for 1986-87 were $10 million; $8 million was for contributions and $2 million for operating expenditures.

12.114 Our audit focused on the management of Fitness Canada's contribution program.

Financial Management and Control

12.115 In our opinion, there is inadequate financial management and control over the administration of the Fitness Canada contribution program.

12.116 The planning and budgeting process does not produce regular reports that link actual resources with expected results. For example, as part of its annual planning exercise Fitness Canada identifies new priorities and target groups for funding purposes. During the 1985-86 exercise, approximately 40 per cent of the budget was allocated to six special target groups, in part through projects exclusively for those target groups and in part through reorientation of programs funded on an annual basis. Although information is available in the Directorate's detailed records, it was not summarized to permit ready identification of the total planned spending for each target group, nor is there regular reporting of actual vs planned expenditures summarized in that manner. In addition, reasons for variances were not produced regularly.

12.117 There is little documented evidence to indicate that the financial viability of projects is adequately challenged before contributions are approved. Although Fitness Canada requires that contribution requests include cost and budget information, it appears that there is only a limited review of the information. Moreover, there is no significant involvement by financial officers in the review process. Proper financial reviews would help to avoid unwise and unnecessary spending of funds. A case in point is the PARTICIPaction Network. Fitness Canada agreed to fund $1 million of the start-up costs (approximately 85 per cent) of a fitness publication service, which was supposed to generate surpluses within two years. By the time the project was judged unsuccessful and terminated three years later in 1986, Fitness Canada had contributed a further $325,000 to finance operating deficits and agreed to pay termination costs of $348,000. Throughout the entire period that the project was funded, there was virtually no involvement of financial officers in the review and challenge of financial information, despite indications of concern about the financial viability of the project.

12.118 Payments are being made in advance of need. Contribution advances are made quarterly in most instances, but this is not based on cash flow projections. In one instance, we noted that one organization (The Canadian Fitness and Lifestyle Research Institute) that is funded entirely by Fitness Canada had $400,000 in short-term deposits on hand at 31 March 1986. During that year it had received $936,000 in contributions.

12.119 Financial reporting requirements are not being enforced. Of the sample we selected for review, which covered 60 per cent of the contribution payments made during 1985-86, approximately 20 per cent of the financial reports had not been submitted as required. Despite the stipulation that payment of advances is conditional on accounting for the previous advance, payments continued to be made even if a financial report had not been received.

12.120 Similar observations, as well as other comments, were made by the Department's internal auditors in June 1984. At the time of our audit, not all their observations had been fully acted on, nor did we see a current or complete action plan to address them. We consider their recommendations to be important in achieving better financial management and control and believe that management should give them its full attention.

12.121 **The Department of National and Health and Welfare should take action to improve financial management and controls over the administration of Fitness Canada contributions by:**

- **ensuring that the results achieved by expenditures, especially those directed to target groups, are measured against planned objectives;**
- **ensuring that all financial reviews of applications for funding are properly documented and that financial officers are appropriately involved in approving and monitoring contributions;**
- **making advances only on the basis of approved cash flow projections;**
- **enforcing requirements regarding the reporting of financial information by recipient organizations and considering withholding advances if such information is not received; and**
- **acting on the recommendations of the Department's internal auditors.**

Department's response: *The Auditor General's concerns regarding accounting for actual expenditures related to priority target groups, and the contributions review and approval process have been noted. Fitness Canada will reassess its practices in the context of the utility of this information for decision making and will also consider improving documentation related to funding decisions as resources permit.*

Fitness Canada has recognized the need for improved procedures in relation to cash flow, monitoring and follow-up when interim and final accounting is not received. Management has already made some improvements to those procedures and is considering others.

More than one-half of the recommendations made by the Department's internal auditors have been acted upon. An action plan for the remainder is being reactivated with the assistance of the NHW Corporate Management Branch.

Efficiency and Effectiveness of Delivery System

12.122 In October 1986, Fitness Canada began a study of the status of the programs and delivery systems of 45 of the organizations it supports, as well as more than 20 others with potential to support the Directorate's objectives. Management anticipates that the results of the study, which was scheduled for completion in May 1987, will indicate how contributions should be awarded in future years.

12.123 We believe that the Directorate also needs to review the efficiency and effectiveness of its own delivery system. There has been no departmental evaluation of the Fitness Canada operation for over 10 years. Although there is a feeling on the part of many of those interviewed that some of its programs have been successful, no current data are available. The Department informed us that an evaluation of this program is planned for the next fiscal year.

12.124 The Fitness Canada delivery system is designed to control contributions project by project. Some of these projects cost less than $2,000. In our 1978 comprehensive audit of the Branch, we pointed out that there were alternative, potentially less detailed and less cumbersome ways of providing financial support to these organizations while still maintaining adequate financial control. A departmental review in 1986 came to the same conclusion. We still believe that it is not necessary to monitor these smaller projects in such a detailed way.

12.125 There are no formal procedures for monitoring and evaluating projects in accordance with Treasury Board requirements. The officers responsible for project monitoring are generally familiar with the organizations and maintain frequent contact with them. But the extent and level of monitoring is left to the discretion of each project officer. Thus, senior management may not be able to assess in a systematic way whether funds are being spent effectively.

12.126 Many of the organizations Fitness Canada supports depend on the federal government for all or most of their funds. They have been doing so for many years. One of

Fitness Canada's criteria for funding ongoing projects is the expectation that they will become self-sufficient. We saw no evidence to indicate that this is ever considered formally in renewing contribution funds.

12.127 Fitness Canada provides contribution funds for both administrative and project support. Although it has detailed guidelines for determining the kinds of expenditures it will fund under each category, the Directorate sets no limits on the proportion of funds an organization may receive for each category. We estimate that 65 per cent of contributions is directed to administrative support. This proportion may not be unreasonable given the type of operations the Directorate funds. However, given that the program has now been in operation for over 25 years and given the current climate of fiscal restraint, Fitness Canada should evaluate whether this proportion continues to be appropriate.

12.128 Approximately 40 per cent of the contribution funds distributed by Fitness Canada are allocated to arm's-length entities. These are entities without share capital and for which the federal government has the right to appoint one or more members of the board of directors or other similar governing body. Fitness Canada needs to assess the cost effectiveness of funding projects through such entities. An example is the Canadian Fitness and Lifestyle Research Institute. In 1985, Fitness Canada decided to transfer responsibility for administering a research program to the Institute. Total annual funding of this program is about $300,000.

12.129 We saw no evidence to indicate that Fitness Canada considered the cost implications of administering the program through the Institute when it made the decision to transfer these activities. It appears that it will cost more to operate the program now than it did before. For instance, the planning document contains provision for Fitness Canada to provide additional resources for establishing and maintaining an advisory council as well as to support other operating expenses. But there has been no corresponding reduction in Fitness Canada's in-house resources. There may have been other more compelling reasons for choosing this delivery mechanism, but financial implications should always be considered in making decisions such as these.

12.130 The Department of National and Health and Welfare should evaluate the efficiency and effectiveness of the Fitness Canada program. In particular, it should:

- **consider more efficient ways of monitoring smaller projects (say, those of $10,000 and less) funded by the program;**
- **formalize procedures for monitoring and evaluating projects in accordance with Treasury Board requirements;**
- **give greater weight to the potential self-sufficiency of ongoing projects when assessing contribution requests;**
- **reassess the proportion of funding directed to administrative support of client organizations; and**
- **ensure that financial implications are fully considered when making major decisions affecting program delivery.**

Department's response: *Fitness Canada agrees that monitoring of smaller projects should be debureaucratized, and action is under way to this effect.*

Procedures for monitoring and evaluating projects have been in effect for some time; consideration will be given to a more formal approach, to provide better linkages and improve decision making.

Assessing the self-sufficiency of projects, assessing the proportion of funding directed to administrative support, and ensuring that financial implications are considered have always been and will continue to be an integral part of Fitness Canada's review and approval processes in relation to contribution funding. The Auditor General's concerns about greater emphasis and better documentation have been noted; improvements will be undertaken as resources permit.

Financial Management and Control Study

12.131 The Department of National Health and Welfare was one of nine departments included in the 1987 government-wide study on financial management and control (see Chapter 4). It was also included in the 1974-76 study of the same name.

Audit Scope

12.132 The current review was carried out primarily in the Department's health program branches as part of our comprehensive audit. We also reviewed financial management and control in Income Security Programs, Social Services Programs, and the Corporate Management Branches. We used the methodology described in Chapter 4, which reports on the whole study. The main areas examined were planning and budgeting, budgetary management and control, reporting, internal control and the financial function.

12.133 In carrying out our review, we also took into account the results of recent external and internal audits.

1974-76 Findings

12.134 These were the major findings of the financial management and control study that was conducted in 1974-76:

- There was no senior financial officer in the Department of National Health and Welfare who had primary responsibility for finance.
- There was no central functional direction to branch financial advisers.
- Key areas of financial management were missing from the financial management manual.
- Internal control was inadequate.
- Internal audit was understaffed.

- There was little reporting of actual results against plans and, where there was, variances were not always explained in terms of costs and outputs.
- Operational managers were not using the financial reports.
- Disclosure in the Public Accounts was inadequate.

Events Since Then

12.135 In conjunction with the Office of the Comptroller General's Improvement in Management Practices and Controls study, the Department initiated a review in late 1978. The project was aimed at, among other things, rectifying many of the weaknesses identified in the 1974-76 financial management and control audit. The review was completed in 1985.

12.136 The Department now has an Assistant Deputy Minister, Corporate Management, who is the senior financial officer. Branch financial officers report direct to him. The Director General, Financial Administration, is the senior full-time financial officer.

12.137 In addition, the Department now has an extensive financial management manual that details accounting policies and practices. It has a reasonably effective internal audit function, and there have been improvements in internal control. However, internal reports still do not link costs and outputs. They are used primarily for ensuring that spending does not exceed appropriations and allotments.

12.138 At the time of our 1987 audit, events were taking place that are likely to have a positive impact on financial management and control in the Department. However, it was too early to assess what their specific effects would be. The following were among the more important of these events:

- The Department was dealing with significant cut-backs in both dollars and person years. By 1991, some 1,700 person-years must be cut – a reduction of 17 per cent from the 1985-86 staff complement of 9,800 person-years. Dollar cut-backs have been both specific to particular objects of expenditure, such as the 1985-86 4 per cent cut in capital funding, and general across-the-board cuts. In 1986-87, the Department was directed to cut $20 million.
- The Department was centralizing departmental administrative services, including the financial function, at headquarters.
- On 1 April 1987, the Department implemented a new department-wide financial system capable of producing better management information.

1987 Findings

12.139 In arriving at an overall assessment of the adequacy of financial management and control in the Department, we took into account that over 95 per cent of total departmental expenditures of $28 billion is for statutory programs, such as Old Age Security and Family Allowances (see Exhibit 12.4).

12.140 Our important findings are summarized below. They are based on the definition of financial management and control set out in Chapter 4.

12.141 **Financial management involves making decisions knowing their implications.** In our 1985 audit of public pension management, we reported that senior financial officers had little involvement in reviewing benefit payment costs for public pensions. Involving these officers more closely, we argued, would facilitate a better understanding of the financial implications of the programs and enhance their overall financial management. Since then, there appears to have been more involvement in this area. In view of the major reorganization of the financial function under way in the Department at the time of our follow-up, we were unable to assess what the extent of involvement of financial officers would be in the future decision-making process for statutory programs.

12.142 In operating programs, the necessary cost information for decision making is not always provided. As an illustration of where it is provided, in our comprehensive audit of the health programs, we found instances where major decisions with significant financial implications were supported by detailed financial forecasts. For example, we were satisfied that the cost implications of alternative means for administering non-insured health benefits for status Indian and Inuit, which are in excess of $160 million, were provided to decision makers.

12.143 As an illustration of where it is not provided, in our review of Fitness Canada, we pointed out that better review and challenge of financial information would have helped to avoid unnecessary expenditures of $670,000 on one of its projects.

12.144 **Financial management involves knowing whether money is spent with due regard to economy, efficiency and effectiveness.** Given the current climate of restraint and the significant cut-back in resources currently under way in the Department of National Health and Welfare, managers are very aware of the need to spend money wisely. But in many instances, they do not have the information and the systems and procedures to allow them to determine whether they are doing so.

- Little effort is made to link the use of resources with operating results, either through the operational planning process or by integrating work planning and budgeting. Examples of this were found in both the Medical Services and the Health Protection Branch.
- Few programs have meaningful performance indicators that can measure either the degree to which program objectives are being met or the efficiency of operations. For instance, although one of the main objectives of the Indian and Northern Health Services activity, which spends over $400 million, is to increase the level of health in Indian and Inuit communities, no records are maintained by community to show the nature and amount of health care provided or the health levels attained. Another example is the Income Security Programs Branch. We

Exhibit 12.4

NATIONAL HEALTH AND WELFARE EXPENDITURE BY TYPE 1986-87 (in millions of dollars)

	Statutory	Operating	Grants and Contributions	Capital	Revenues Credited to Vote	Total
Income Security	15,979	105	-	1	(36)	16,049
Health Services and Promotion	6,621	23	35	-	-	6,679
Social Services	4,093	14	17	-	-	4,124
Medical Services	-	340	94	29	-	463
Health Protection	-	116	-	19	-	135
Fitness and Amateur Sport	-	11	58	-	-	69
XV Olympic Winter Games	-	2	25	20	-	47
Departmental Administration	-	44	2	2	(2)	46
	26,693	655	231	71	(38)	27,612

Source: 1986-87 Public Accounts.

have been expressing concern for the last 10 years about the ability of its performance measurement systems to measure adequately the productivity of its 2,900 employees.

- The Corporate Management Group did not have adequate information to apply cuts and monitor the recent spending freeze. This was because of inconsistent and untimely commitment information from the program branches.

12.145 But there are exceptions. For instance, as discussed earlier, there are systems that provide for good accountability and control of Health Services and Health Promotion activities. Expenditures in this area amount to over $50 million every year. Projects undertaken have specific targets and results to be achieved within a given time frame. Milestone information is integrated with project budget figures and this information is regularly reviewed with a view to taking corrective action when required.

12.146 **Financial management involves satisfying the requirements of Parliament, Treasury Board and departmental management for financial accountability.** National Health and Welfare has responded to the needs of Parliament and Treasury Board for information through the Operational Plan Framework (OPF), Multi-year Operational Plans and Part III of the Estimates. But there are weaknesses in all these documents. Resources are not adequately linked to results. There has been little in the way of progress reporting on new initiatives. There is inadequate disclosure of certain program costs; the Indian and Northern Health Services activity is an example. The Operational Plan Framework contains no reference to non-insured health benefits despite the fact that they represent 40 per cent of this activity's costs. As the OPF sets the framework for what is subsequently reported in the Estimates, the information to Parliament about the $400 million Indian and Northern Health Services activity is inadequate.

12.147 We saw no evidence that these documents are being used, internally or externally, to demonstrate financial accountability. We are concerned that, in their present form, these documents are not adequate vehicles for financial accountability to Treasury Board and to Parliament.

12.148 The primary concern of departmental management these days is to ensure that funds are spent within budget constraints. The Senior Management Committee has asked Financial Administration to provide information on projected surpluses and lapses only. The Committee has not identified any need for other types of financial management information.

12.149 **Financial control involves safeguarding assets.** Physical assets under the Department's control are generally appropriately safeguarded. We have identified some minor weaknesses. These have been discussed with the Department but they are not significant overall.

12.150 **Financial control involves ensuring the accuracy and reliability of accounting data.** Our annual financial audits lead to the expression of an audit opinion on the accounts of Canada. In recent years, this work has not revealed any significant errors in the accounting data. The data provided by the Department's financial reporting system are accurate and reconciled regularly with branch systems.

12.151 **Financial control involves ensuring money is spent for the purposes intended.** Statutory payments account for most of the Department's expenditures. In general, National Health and Welfare has good procedures for controlling these funds, particularly for statutory payments to individuals. In our 1985 report on public pension management, we reported that the Department places great emphasis on maintaining a high level of service to the public and particularly on ensuring that benefit payments are made on time.

12.152 The Department has an effective internal audit function that reviews the management and accounting practices of each program on a cyclical basis. However, we found that where deficiencies in controls have been identified, the Department is often slow to take remedial action. For example, the audit of provincial claims is a key control in the Canada Assistance Plan. In 1978, we reported on the unduly lengthy process for settling these claims and on the lack of standards and procedures. The same situation still exists.

12.153 **Financial control involves ensuring that spending does not exceed the levels approved by Parliament.** The Department limits its spending to those levels approved by Parliament. In fact, controlling funds and person-years within allotments and appropriations is the main preoccupation of financial officers and senior management.

DEPARTMENT OF TRANSPORT

DEPARTMENT OF TRANSPORT

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13

DEPARTMENT OF TRANSPORT

Environment

13.1 Transport Canada's role is to attend to the development and operation of a safe and efficient national transportation system that contributes to achieving government objectives. In air transportation, the Department is a regulator and operator of Canada's major airports. In the area of water transportation, it operates the Canadian Coast Guard, which undertakes icebreaking, maintains aids to navigation and search and rescue activities and administers designated harbours and port facilities. In surface transportation, it administers urban transportation and highway safety programs. The Department's operations include activities in a quasi-commercial environment, such as those undertaken by the Airports Authority Group which recovers costs from users, including airlines and concessionaires at individual airports. The nine largest airports are administered through the Airports Revolving Fund.

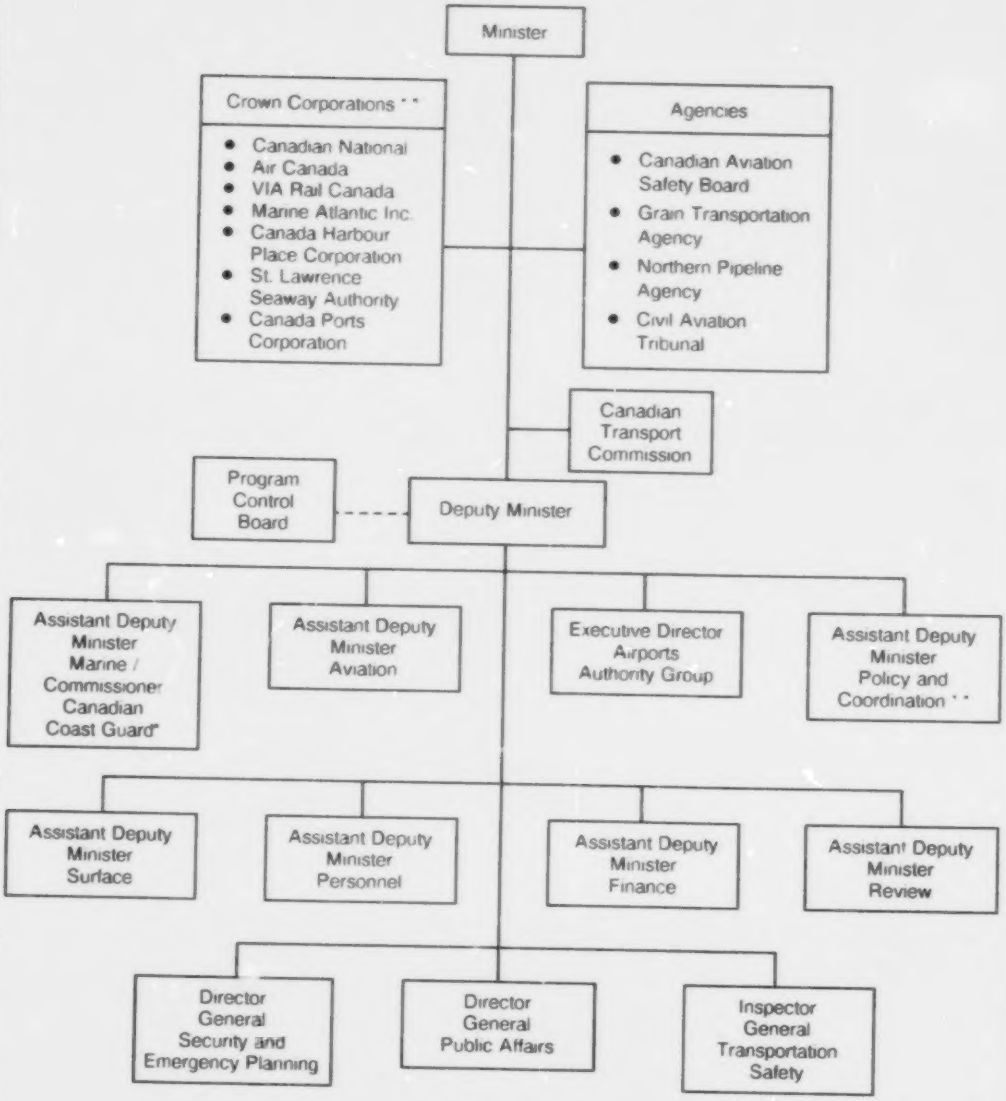
13.2 Transport Canada makes large capital investments each year. Capital expenditures for the 1986-87 fiscal year included airport renovations and expansions, expanded air and marine navigation services, ship acquisitions and modifications, dock reconstruction and wharf extensions, at a cost of $642 million. Marine capital expenditures include vessels acquired as part of the Department's Fleet Capital Investment Plan, which provides a scheduled approach to replacing 49 major vessels over a 20-30 year period. The costs of operating and maintaining capital assets acquired in these and prior years will have a significant impact on both current and future years' operating expenditures. For example, runway extensions will add to future years' airport maintenance costs. And to the extent that costs cannot be recovered from users, new or expanded airport terminal buildings will result in increased net operating costs. Similarly, expanded marine navigation services will lead to an increase in future operating costs.

13.3 Transport Canada is carrying out a department-wide reorganization. It has split the old Air Administration into two units, Aviation and Airports. Harbours and Ports have been combined with the Canadian Coast Guard into a single Marine Program Group. The Surface Program's responsibilities for subsidies and payments to Crown corporations have been transferred to the Policy and Co-ordination Group, leaving Surface with a much smaller budget. The revised organization structure is shown in Exhibit 13.1.

13.4 Transport Canada has entered into an Agreement on Deficit Reduction Principles with the Treasury Board, covering the period 1985 to 1991. The Department plans to reduce net expenditures by $1.2 billion over this six-year period, as follows: $75 million in 1985-86, $100 million in 1986-87, $150 million in 1987-88, $200 million in 1988-89, $300 million in 1989-90 and $400 million in 1990-91. In addition, there is a reduction of $750 million in VIA Rail subsidies planned during the same period. These reductions are to be achieved through a combination of increased cost recovery, reduced costs and reduced transfer payments.

Exhibit 13.1

TRANSPORT CANADA ORGANIZATION


Minister
Crown Corporations **
Canadian National
Air Canada
VIA Rail Canada
Marine Atlantic Inc.
Canada Harbour Place Corporation
St. Lawrence Seaway Authority
Canada Ports Corporation
Agencies
Canadian Aviation Safety Board
Grain Transportation Agency
Northern Pipeline Agency
Civil Aviation Tribunal
Canadian Transport Commission
Program Control Board
Deputy Minister
Assistant Deputy Minister Marine / Commissioner Canadian Coast Guard*
Assistant Deputy Minister Aviation
Executive Director Airports Authority Group
Assistant Deputy Minister Policy and Coordination **
Assistant Deputy Minister Surface
Assistant Deputy Minister Personnel
Assistant Deputy Minister Finance
Assistant Deputy Minister Review
Director General Security and Emergency Planning
Director General Public Affairs
Inspector General Transportation Safety

* Includes budgetary funding responsibility for the four Pilotage Authorities, Canarctic Shipping Co., and Harbour Commissions.

** For budgetary funding purposes, all Crown corporations except CN, Air Canada and Canada Harbour Place Corporation report to the Minister through the ADM Policy and Coordination.

13.5 A Program Control Board has been established to provide a formal, independent, corporate challenge function for major operating and capital decisions in the Department and to facilitate setting priorities and transferring resources among various competing activities. The members of the Board are the Assistant Deputy Ministers from each of the operating groups. As such, they have assumed the role of an "internal treasury board" that makes major decisions on the Department's resourcing activities, including fund transfers among the various groups.

13.6 Decisions taken before the Board was established, however, still have an impact. For example, capital investment decisions in prior years affect the current year's capital expenditures. The Board's review of vessels acquired under the Fleet Capital Investment Plan is limited in the sense that the purchases are already approved in principle.

13.7 Effective 1 April 1986, the financial function was centralized. All financial officers and staff in the Department now come within the jurisdiction of the senior financial officer (the Assistant Deputy Minister, Finance) except for the Resource Management Units in each program group that provide a financial support function to operating managers. The Resource Management Units carry out an internal challenge function on incremental resource requests received from regions. Their advocacy role within the Department takes over once this challenge process has been completed.

13.8 The senior financial officer has been assigned specific responsibilities, including co-ordinating the planning and resource allocation process with the financial control system, designing and operating management information systems, providing financial services, safeguarding assets and performing financial and economic cost benefit analysis of major resource programs. A Cost Recovery and Economic Evaluation group has been established to formalize cost-benefit analysis, co-ordinate the development of cost accounting information and provide a focal point for the Department's extensive cost recovery efforts.

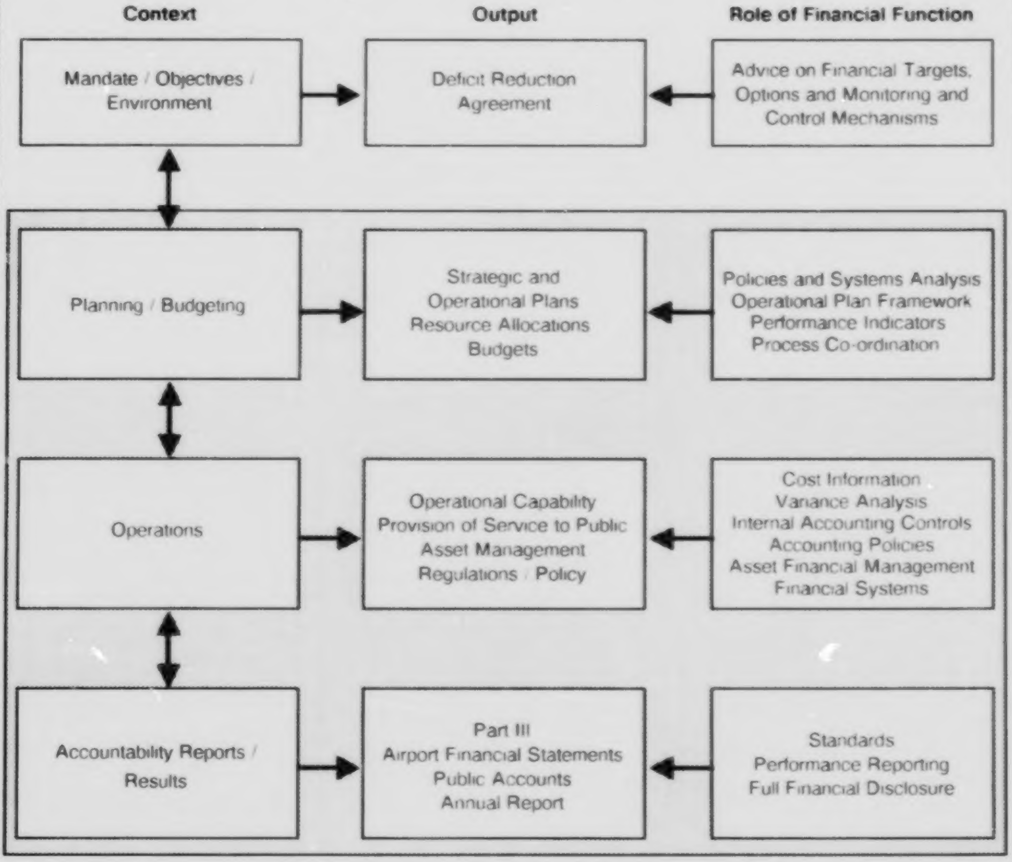
Scope and Audit Approach

13.9 The purpose of our audit was to determine whether the financial management systems and controls were adequate. Our examination also followed up on deficiencies noted in our 1974-76 Financial Management and Control Study and subsequent value-for-money audits.

13.10 This was a department-wide audit focusing on financial outputs, whether produced by the formal financial organization headed by the senior financial officer, or others in the Department charged with financial responsibilities. The shaded portion in Exhibit 13.2 illustrates the role of the financial function in relation to the Department's key activities. Our audit examined this role in the areas of Planning and Budgeting, Operations and Accountability Reports.

Exhibit 13.2

FMCS AUDIT SCOPE IN TRANSPORT CANADA


Context
Output
Role of Financial Function
Mandate / Objectives / Environment
Deficit Reduction Agreement
Advice on Financial Targets, Options and Monitoring and Control Mechanisms
Planning / Budgeting
Strategic and Operational Plans
Resource Allocations
Budgets
Policies and Systems Analysis
Operational Plan Framework
Performance Indicators
Process Co-ordination
Operations
Operational Capability
Provision of Service to Public
Asset Management
Regulations / Policy
Cost Information
Variance Analysis
Internal Accounting Controls
Accounting Policies
Asset Financial Management
Financial Systems
Accountability Reports / Results
Part III
Airport Financial Statements
Public Accounts
Annual Report
Standards
Performance Reporting
Full Financial Disclosure

Scope excludes Internal Audit, Program Evaluation.

13.11 We also examined selected aspects of three subsidy programs to assess the adequacy of program controls. These subsidy programs are the statutory responsibility of the Minister of Transport and are administered by the Canadian Transport Commission, a separate regulatory agency established by Parliament in 1967.

Planning and Budgeting

13.12 Past audits of Transport Canada have reported a number of instances where there was insufficient analysis and evaluation of alternatives before major capital investment decisions were made. For example, our comprehensive audit of the Marine Transportation Program in 1983 noted that the Department had neither adequately analysed the needs of mariners for services provided to them nor defined the extent and quality of services to be provided. Our Air Transportation Program audit in 1985 found that the investment planning process had serious weaknesses, leading to a pattern of investments that had little hope of recovering their costs. For example, the audit reported that in planning expanded terminal facilities at Ottawa International Airport, the Department did not obtain commitments from airlines that would enable it to recover its costs. And no analysis was carried out to assess the implications for the Airport Revolving Fund of the shortfall that would result from providing the additional space without cost recovery.

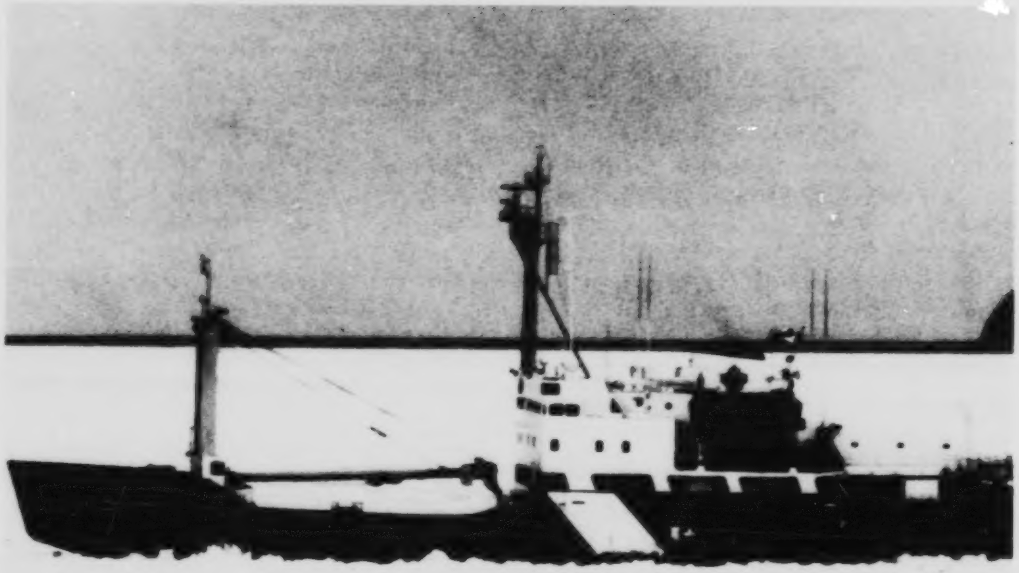
Resource Allocation

13.13 The Program Control Board was created to address these and other departmental concerns. We found that the Board has provided a strong and independent challenge of incremental resource requests for capital and operating funds. This "top-down" approach has been successful in challenging major planned expenditures and in ensuring that overall corporate priorities are reflected in allocating resources. For new capital projects, the quality of option analysis and the assessment of cost recovery opportunities have significantly improved. But the effectiveness of the Board's review of the existing resource base has been restricted by the effect of previous years' capital investment decisions on current operating costs and by weaknesses in the Operational Plan Framework. These weaknesses include imprecise statements of results, few performance indicators for economy and efficiency, insufficient number of formally defined levels of service and inadequate cost information.

13.14 The Department has restructured its Operational Plan Framework to match its revised appropriations vote structure shown in the Estimates and to reflect the recent department-wide reorganization. This framework, which received conditional approval from Treasury Board, was used as the basis for the 1987-88 detailed operational plans. Given the evolving nature of the framework, it is too early to judge its ultimate usefulness. However, we are concerned about the lack of linkage between costs and results.

13.15 We found instances where managers were not in a position to control fully the costs in their budgets. For example, managers in a Marine region are responsible for assisting mariners in determining their position at sea. They are responsible for the budgeted expenditures of tending, or maintaining, navigational aids. But they cannot select the ship to meet their needs or control the costs of the "multi-tasked" ships used. A Class 1100 multi-tasked vessel assigned to navigation aids duties could cost twice as much per day as a smaller ship dedicated to tending the aids. These ships are assigned by a fleet manager from the ships allocated to him by headquarters, based on his analysis of the demand for ship hours in the region, availability and urgency. The objective is to select the most appropriate vessel available to meet the service demand.

13.16 However, this demand for ship hours is not based on defined and documented levels of service. Instead, the level of service is based on topography, water conditions, types of marine traffic, past experience, policy direction, etc. National unit costs, which might provide a basis for challenging resource requirements, have not been developed. The Department informs us this is because of the variation in the types of ships used, the lack of defined levels of service and the reality that a national unit cost approach would not permit recognition of the widely different operating environments found in the country.



Two multi-tasked vessels used for tending navaids and light icebreaking – The CCGS Samuel Risley *(Type 1050) and The CCGS* Martha L. Black *(Type 1100). The different operating cost patterns of each ship make it difficult to develop meaningful unit cost standards for like tasks such as tending navaids (see paragraph 13.15).*

13.17 Our inquiries focused on whether the Department had developed regional standards for levels of service and unit costs, once it knew that it would not be possible to develop national standards. The Department has not developed regional standards linking a "market basket" of services to be provided with the available resources - for example, a given complement of ships - and with a list of expected results. Such regional standards would be based on regional unit costs developed over time and would make it possible to relate resources to results.

13.18 The Department has advised us it is currently working at rationalizing and establishing reliable and meaningful performance indicators. But Transport Canada believes it will take a few years to establish trends and identify criteria for evaluation. Some information has been gathered over the last few years but what would constitute most useful indicators has yet to be determined.

13.19 We also found that the lack of a departmental policy on cost recovery and the lack of business plans with recovery targets have impeded airport cost recovery efforts. There are too few cost-based variance reports that measure actual financial performance against specified targets for controlling costs and maximizing revenue. The Department states it has recognized the need for a new cost recovery policy, and has developed a proposed general policy which is currently under consultation with the transport industry and other interested parties. Following completion of this phase, the Department states it plans to develop specific cost recovery proposals this fall, including fee structure and recovery targets which will also be the subject of consultation. The Department anticipates that this process will be completed in the first half of 1988, after which time a formal cost recovery plan for its air and marine facilities and services will be established.

13.20 There are elements of a "paper exercise" in the existing planning process. For example, in the Canadian Coast Guard operations we noted detailed work plans that managers said they were not using to manage their operations. Managers stated that the plans were prepared primarily to fulfil a systems requirement. In our opinion, given the Department's fixed resource levels for the last two years and the next four, coupled with the top-down targets set by the Program Control Board, such detail in work plans prepared largely to justify resource requests is not needed.

Advice and Analysis

13.21 As noted earlier, our previous audits found serious weaknesses in the financial advice and analysis provided on capital project decisions. The Department had frequently approved projects without analysing the effect on future costs or identifying cost recovery opportunities. The focus of this year's audit was on whether the situation had improved.

13.22 We found that the quality and effectiveness of financial advice and the analysis of capital projects had improved in the submissions we examined, particularly for the last two years. In our opinion, this reflects the effectiveness of the Program Control Board and the competition for scarce incremental resources caused by the deficit reduction exercise. The quality of project submissions and the financial and operational data presented in support of proposed projects had improved. Overall, there is a much greater awareness in the

Department of the need for cost-conscious resource allocation and for a critical analysis of proposed capital expenditures. This is illustrated by the following cases.

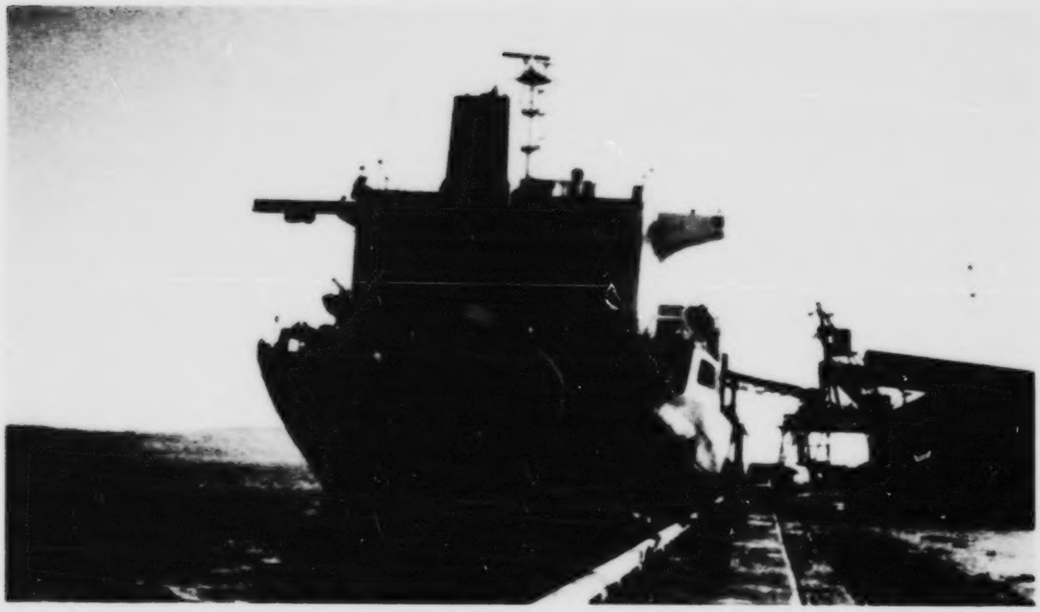
13.23 We examined one project that had been approved before the Program Control Board was established. Our audit of the 1050/1100 Navigational Aid Tenders and Light Icebreakers revealed that this $500 million project went ahead without life-cycle costs being developed specifically for the eight vessels involved. The Department states that although cost data did exist on annual refit costs, fuel consumption and mid-life modernization, they were not consolidated in one place, nor did they cover the whole life of the proposed vessels. The effect of these deficiencies is that the Department could acquire vessels that are unnecessarily costly to operate, relative to their assigned mission.

13.24 By contrast, in its review of the Microwave Landing System project, with an estimated total cost of $450 million, the Program Control Board asked for and received a comprehensive cost-benefit analysis of the proposal and an assessment of plans for cost recovery. The Board expressed the view that systems should only be installed at sites where there was clear justification for the equipment. In giving conditional approval to a $6.5 million Microwave Landing System installation at the Toronto Island Airport, the Board insisted that a cost recovery arrangement with the airport owner be negotiated before the installation can be made operational.

13.25 We looked at two recent wharf projects, the St. Lawrence, Newfoundland, wharf strengthening, for $2.5 million, and the Dalhousie, New Brunswick, wharf extension, for $4.9 million. Each project provided for 100 per cent cost recovery from a clearly identifiable beneficiary, the corporation using the wharf. Another project that mirrored this increased awareness of cost recovery was the establishment of an improved United States pre-clearance facility at Lester B. Pearson International Airport in Toronto. The Department ensured that the major beneficiaries, the airlines, signed commitments before construction began on this $5.2 million project, scheduled for completion in October 1987.

13.26 The proposed construction of a third terminal at the Pearson International Airport illustrates the type of approach that the Department is pursuing. They evaluated the options available to relieve capacity problems in the two existing terminals and selected the construction of a third terminal as the most cost-effective solution. The Department requested proposals from the private sector for the funding and operation of a third terminal that would meet its requirements. The proposals have been evaluated and the Department has selected a private sector solution. We will be examining this process and its results during subsequent audits.

13.27 A recent internal audit concluded that there was a weakness in the planning and analysis of minor capital projects (under $250,000). These projects, which represent approximately 10 per cent of all capital expenditures, are approved at the regional level. In many cases, minor capital projects approved in the capital budget were replaced by other projects during the year. For example, it was reported by internal audit that 49 per cent of the minor capital budget for Air in 1984-85 was spent on replacement projects. Our review confirmed the reduced level of analysis in the regions. The Department states that in order to



Dalhousie, New Brunswick, wharf extension that cost $4.9 million and provided for 100 per cent cost recovery from a clearly identifiable beneficiary, the corporation using the wharf (see paragraph 13.25).

address the weaknesses in the process for approving minor capital projects, airports program control boards have been established in all regions and at major airports.

13.28 We concluded that the continued weak planning and analysis at the regional level in part reflected the need for further clarification of the roles of the regional financial officers. Currently the operational branches and the finance branch are negotiating a memorandum of understanding that will define the roles of the regional financial officers and the Resource Management Units.

Operations

Accounting Policies and Practices

13.29 **Capitalization policies for the Airports Revolving Fund.** The Department has not regularly reviewed and, where appropriate, updated its policies for capitalizing asset costs. These have a direct impact on cost-recovery decisions related to the capitalized costs. For example, the capitalization policies and practices covering the Airports Revolving Fund assets of $1 billion require that expenditures for individual assets or additions with a value of $500 or more should be capitalized. This practice is cumbersome and time consuming. It requires capitalization of items that commercial enterprises would normally report as expenses. For example, small runway repair projects are being capitalized under this policy. They are more appropriately charged to expenses. The Department has started a review of its fixed asset accounting policies, including an appropriate threshold for capitalizing fixed assets.

13.30 **Accounts receivable policies and practices.** In 1986-87 the Department had annual receipts in excess of $900 million. Commercial revenue is generated principally from the Department's operations at Canada's nine major airports, including rentals and concessions at the airports. Other significant receipts include the air transportation tax. Revenues receivable at 31 March 1987 were over $50 million.

13.31 In the past, the Department had not managed revenues receivable in a business-like fashion. Serious weaknesses existed in the areas of granting credit, billing, collecting and reporting. Recently, we have noted signs of improvement, for example, the reduced age of accounts receivable.

13.32 *Granting credit.* In the past, the Department did not require a credit check on prospective lessors/concessionaires at airports. Such a check would enable it to refuse to award leases/concessions to companies with outstanding debts, bad credit histories or other high risk considerations. In one case, the Department granted a second lease to a company that was five months in arrears on its first lease with the Department. It then allowed the company to continue operating for more than two years without paying rent.

13.33 Government contracting regulations for leasing encourage the acceptance of proposals that include the highest fixed lease payments, without stressing other factors such as the reasonableness of the amounts tendered, or the credit history of the company or of other companies owned or operated by the same (or associated) principals. Sometimes this has resulted in accepting poor credit risks who make unrealistic guarantees of future payments. In one such case, the Department will likely lose $1.4 million owed by a concessionaire who was unable to meet his commitments. Exhibit 13.3 illustrates some of the problems that came to our attention during our audit. The Department states that most of the cases occurred during a particularly difficult downturn in the economy in western Canada where many businesses were suffering cash flow problems. The Department states its thrust was to retain business in a time of restraint and that it is developing guidelines for awarding contracts to high risk lessors/concessionaires.

13.34 *Billings.* To get receivable accounts more current, the Department decided to start charging interest on overdue accounts for landing fees and general terminal charges. However, to do so, it had to change the Aeronautics Act and establish enabling regulations.

13.35 Revisions to the Aeronautics Act were tabled on 28 March 1985. The Act was passed on 20 June 1985. The regulations were published in the *Canada Gazette* on 1 December 1986, and the Department finally obtained authority on 15 January 1987, 45 days after publication in the *Gazette*. This process took almost two years. The opportunity cost for the 18-month interval between the passage of the Act and the implementation of interest charges was $500,000. This case further illustrates the constraints inherent in operating in a quasi-commercial environment while complying with government regulations.

Exhibit 13.3

CASES: ACCOUNTS RECEIVABLE MANAGEMENT

Phase	Case	Major Findings	Overdue Amount ($000)
Granting Credit	Concession A	- contract award based on unrealistically high tender. - reluctance to apply policy and cancel lease promptly when payments were not made.	$1,400
	Concession B	- failure to cancel agreements promptly when payments were not made.	75
	Concession C	- second lease awarded although lessee already in arrears on first lease. - failure to cancel agreements promptly when payments were not made.	53
	Concession D	- concessionaire allowed to continue operations while experiencing payment difficulties at two other airports.	53
Billings	Concession E	- failure to bill or take collection action on 6 new leases signed up to 16 weeks previously.	-
	Concession F	- 11-month delay in invoicing lessee.	14
Collections	Concession G	- failure to take prompt collection action when lessee accumulated arrears.	34
	Concession H	- receivable not monitored properly - no collection action for 5 years because of confusion over whom to bill.	25

13.36 *Collections.* Exhibit 13.4 illustrates a positive trend in collecting accounts receivable. In the past, the Department's procedures and practices were either not sufficiently responsive to commercial realities to protect the Department's position fully, or, in some cases, were not followed vigorously. In our opinion this was caused in part by a reluctance to press early, when action would have been most effective. More recently, the Department has taken a number of actions to improve collections, such as appointing collection officers and using collection agencies. This has resulted in a marked reduction in the age of accounts receivable.

13.37 *Reporting.* The formal departmental reporting system presents an incomplete picture of the Department's receivables. For example, self-billings from Air Canada, one of Transport Canada's largest clients, are excluded from the national accounts receivable reports which should present a complete, summarized picture of receivables. As of 31 March 1986, the reported amounts did not include at least $6.3 million of receivables.

Exhibit 13.4

TRANSPORT CANADA
NATIONAL AGED ACCOUNTS RECEIVABLE
(in thousands of dollars)

	Total Current (1 - 60 Days)	61 - 90 Days	91 Days and Over	Suspense	**Total Non-Current**	Total
1984	**19,053** **(46%)**	2,346 (6%)	7,476 (18%)	12,659 (30%)	**22,481** **(54%)**	41,534 (100%)
1985	**17,607** **(47%)**	2,071 (6%)	6,936 (19%)	10,156 (28%)	**19,163** **(53%)**	36,770 (100%)
1986	**22,015** **(55%)**	2,369 (6%)	5,238 (13%)	10,218 (26%)	**17,825** **(45%)**	39,840 (100%)
1987	**25,652** **(59%)**	2,696 (6%)	7,266 (16%)	8,205 (19%)	**18,167** **(41%)**	43,819 (100%)

13.38 Moreover, the picture presented is distorted because, as illustrated in Exhibit 13.4, 19 per cent of the accounts at 31 March 1987 were in suspense; that is, they are currently with the Department of Justice, are pending deletion, are owed by insolvent companies or have been inactive for at least five years. In short, their inclusion in the report distorts the true corporate picture, rather than focusing attention on collectible accounts that head office and regional collections officers can control. The formal summary report is generally not a useful tool for monitoring collections because the information is highly summarized and does not explain significant increases or decreases in receivables. It does not report variances from specified collection targets and generally is not useful for pinpointing specific areas of poor collection performance.

13.39 The Department states that constraints to effective policies and practices include the environment within which the Department operates. This includes such things as the rigidity of the tendering regulations. By-passing a "best value" competitive tender solely for reasons of a company's poor credit rating is difficult under the current practices which do not explicitly include this criterion as a major determining factor in awarding the contract. The Department further states it feels constrained by the lack of central agency direction concerning debt deletion.

13.40 In our opinion, the problems we observed stem partly from the fact that the Department operates in a quasi-commercial environment, yet is accountable for compliance with rules primarily designed for managing cash and appropriations. Government-wide directives, such as those dealing with debt deletion, impede managers' flexibility and limit the Department's options.

13.41 The Department states that the Commercial Property Management Procedures Manual being developed as part of the Commercial Property Management Implementation Project will address some of these issues. For example, the Airports Authority Group has issued guidelines for rejecting unreasonable bids in concession tenders.

Cost Information and Variance Reports

13.42 **Variance reports**. At the corporate and operational level, managers receive information suitable for keeping expenditures within appropriations and allotments. The principal information tool at the corporate level is the Resource Utilization Status Highlights (RUSH) report. It generally meets the needs of the Program Control Board to manage corporate commitments and reserves. Operational managers rely on the reports produced by the Department of Supply and Services' Departmental Reporting System. These reports, although not always timely, generally provide the information needed to control revenues and expenditures at the operational level.

13.43 **Cost-based information**. Although the Department now has some cost information, it is incomplete and not always timely. Most of it is collected manually, because the Department has few automated cost accounting systems. Improved systems could support cost recovery efforts by providing information for rate setting, rate justification and detailed billings. They could also help control operating costs. For example, for the nine self-supporting airports within the Airports Revolving Fund, at both the Fund and individual airport levels, cost information was generally not available on a timely basis or by the three result areas the Department considers key – the air field, terminal, and industrial areas. Consolidated financial statements, on a full accrual and costed basis, were not available until over five months after the year end. In our opinion, this lack of cost information precludes a realistic approach to setting and justifying rates and controlling costs. Exhibit 13.5 illustrates the type of cost information available at major airports. The difference in accounting practices followed by these airports makes meaningful comparative analysis difficult.

13.44 The lack of adequate cost information also makes it difficult to monitor the costs of providing Marine Services. Managers could make better informed operational choices if the costs of competing options were known. For example, while some cost information is currently available in the Marine Cost Accounting System, better cost information on fuel costs (adjusted for changes in inventory) would assist managers in making more informed decisions on the costs of operating under various alternative sets of conditions.

13.45 Because of the lack of timely cost information the Department does not always know whether it is making or losing money on a monthly basis by key result areas where it operates in a quasi-commercial environment. Cost information could help the Department pinpoint avoidable losses. It could also support greater cost recovery and assist managers in controlling costs. A recent internal report identified terminal building revenue and expenses for 23 major airports for 1985-86, including the nine major airports shown in Exhibit 13.6.

Exhibit 13.5

MONTHLY FINANCIAL REPORTING PRACTICES OF SELECTED MAJOR FEDERAL AIRPORTS

Airport *	Basis of Accounting - accrual or cash **	Type of Information Key Results Areas ***
Dorval	Cash - modified accrual for expenditurees	No matching of costs and revenues by key results areas.
Mirabel	Accrual	Information available for concessionaires and public parking but no matching of costs and revenues by key results areas.
Pearson	Accrual	Matching of costs and revenues by activity in detailed reports, but no matching of costs and revenues by key results areas.
Calgary	Cash	Information available for concessionaires but no matching of costs and revenues by key results areas.
Edmonton	Cash - modified accrual for expenditures	Information available for concessionaires by aircraft revenue type and airline but not matching of costs and revenues by key results areas.
Vancouver	Modified accrual	No matching of costs and revenues by key results areas.

* No airports prepare monthly balance sheets.

** All statements exclude interest costs, services provided without charge from other government departments and depreciation (except for Pearson which estimates depreciation).

*** Most airports report information by responsibility centre or line object. The key results areas identified by Transport are the airfield, terminal and industrial areas.

Although summary information by terminal building is available, more detailed cost and revenue breakdowns of this information are not generally available. These would help identify areas where recoveries could be improved by increasing revenues or reducing costs. Although to date a comprehensive cost recovery policy has not been adopted, the Department states that 100 per cent cost recovery is not an objective because it will sometimes be in the public interest to subsidize certain groups of users. The Department states that it believes users should not be expected to pay for all costs such as portions of the costs of regulating safety and security.

13.46 Management recognizes that more detailed information is needed. The internal report focused attention on recoveries at the airport level, but raised new questions, such as the differences in performance between airports, that could not be answered because of a lack of detailed cost information.

Exhibit 13.6

AIRPORT TERMINAL BUILDINGS REVENUES AND OPERATING EXPENSES
1985-86
(in thousands of dollars)

Major Airport	* Revenue	** Expenses	Over (Under) Recovery	Cost Recovery Percentage
Halifax	$ 3,119	$ 5,433	$ (2,314)	57.5%
Dorval	12,108	23,333	(11,225)	51.9%
Mirabel	8,394	28,972	(20,578)	29.0%
Ottawa	4,843	8,252	(3,409)	58.7%
Pearson	48,842	54,131	(5,289)	90.2%
Winnipeg	4,251	7,067	(2,816)	60.2%
Edmonton	5,732	12,474	(6,742)	46.0%
Calgary	10,505	20,354	(9,849)	51.6%
Vancouver	20,416	19,392	1,024	105.3%
	$ 118,210	$ 179,408	$ (61,198)	65.8%

* Includes concessions, rentals, leases, terminal charges and passenger security fees but excludes air transportation tax allocation.

** Includes direct and indirect operating expenses attributable to revenue producing activities. Direct operating expenses include salaries and wages, materials and supplies, purchased services and mobile equipment costs. Indirect costs include allocated overhead, depreciation, employee fringe benefits and grants in lieu of taxes, but excludes interest associated with amounts contributed to the Airports Revolving Fund.

13.47 The Department states that the key result areas for the Airport Authority Group have been developed only recently through the Operational Plan Framework. These are being implemented in the 1987-88 fiscal year. The expenditures and revenues will be available by key result area during 1987-88. The Department also states it is taking action to improve the availability of cost information by initiating studies to determine relevant costs and match costs and revenues on a commercial accounting basis.

13.48 We also found that the absence of a business plan for the Airports Authority Group hindered the control of costs. There were no cost-based variance reports that measured actual financial performance against individual airport targets as an aid to improving cost control and maximizing revenue. The Department has recognized this need and is currently developing a cost accounting system for individual airports. The Department states that a five-year Airports Business Plan is expected to be finalized during this fiscal year.

13.49 In the Aviation and the Marine groups, the cost information available was not sufficient to support cost recovery initiatives. A proposed cost recovery policy is under consultation with users that will define the expected levels of cost recovery within the Department. However, implementing it may be hampered by a general lack of centrally available information on asset and operating costs. The Department states that the proposed policy makes explicit provision for the recovery of certain Aviation and Marine costs, and that considerable work is in progress to develop the necessary cost accounting information.

13.50 In pointing out the need for better cost information to control costs and assist cost recovery initiatives, we do not mean to imply that the Department should necessarily develop a number of national cost accounting systems. Excessively detailed information or overly complex systems are not needed. We recognize that the cost information supplied to managers must be timely and in a form that they can use. However, there is a need for more comprehensive cost information, particularly summary cost information, and costs of different lines of business to assist senior managers.

Asset Management

13.51 Important corporate resources, such as inventory and real property (land and buildings) worth at least $10 billion, are not being managed as potential revenue-producing assets, even though they are important sources of cash now and in the future. So far in the current deficit reduction exercise, the Department has given a low priority to the need for stronger financial management controls and corporate level, summarized financial information on these important assets. This financial information is necessary to support improved cost recovery, to justify investment decisions and to identify surplus or obsolete assets available for disposal.

13.52 The Department has set up systems and procedures to ensure that the custodial function is adequately discharged. Most program managers know what they own in terms of size, location and physical condition. Except for the $40 million of inventory covered by the Stores Revolving Fund, what they do not know is what the asset originally cost, the highest or best use it could be put to, its current market value, and most important, what it costs to "hold" a particular asset. Such information could be estimated by a one-time study that identified the relevant costs and then updated periodically.

13.53 **Inventory**. As calculated by internal audit, the Department spends at least $28 million annually to manage inventories valued at $200 million. These include consumable inventories that are kept in stores (uniforms, stationery, chains and shackles, etc.), back-up parts for ships, aircraft and telecommunications equipment (aircraft engines, ships propellers, etc.), spare parts with an ongoing and predictable pattern of use, and custodial items (a combination of consumable inventory and spare parts controlled solely by responsibility centre managers). The Stores Revolving Fund, which provided a limited level of central financial control over almost $40 million of stock, was terminated on 1 April 1987, because of difficulties experienced by the Department in costing stock issues.

Auditor checking the consumable inventories included in the Department's inventories valued at $200 million (see paragraph 13.53).

13.54 The Fund had established a purchasing ceiling and provided Fund statements to managers with information on inventory levels relating to the $40 million of stock. But it provided no control over the remaining $160 million in inventory. Had it taken advantage of economies of scale and extended these controls to the other $160 million of inventory, the Department estimates it could have avoided surplus stock of $11 million with annual holding costs in excess of $1 million. While some controls exist at the site level, overall, there is little or no co-ordination or rationalization of inventories owned by the Department.

13.55 For the $40 million of stock in the Stores Revolving Fund, which includes both consumable inventories and spare parts, there was adequate financial information to make informed decisions on what to purchase and what to hold. However, it was not always used effectively to monitor inventory levels in the Fund. The Fund had a turnover rate of .55, which means that inventory turned over on average every 22 months.

13.56 A recent study attributed the low turnover rate to such factors as delays in writing off obsolete stock and the need for Coast Guard ships to carry full inventory levels at sea. An internal study of depots located in the west revealed that 33 per cent of the Fund's items showed no movement in the last year and a half, and that a one-time saving of at least $700,000 to $1 million could be attained through rationalizing inventory practices. In addition, obsolete stock costing $4.5 million has been accumulated over the years, resulting in added holding costs. The Department informs us that subsequent to our audit this has been disposed of and the write-off approved.

Land and buildings at Mirabel International Airport that are part of the Department's extensive real property holdings (see paragraph 13.63).

13.57 Information on inventory valued at $160 million provides no summary-level financial reporting that provides a consolidated picture of inventory holdings for each program, by region. Such a summary could be used to provide information on the build-up of inventory and to monitor inventory levels.

13.58 The Department also does not have a complete master listing, by site, of items in common use across the country. Such information would facilitate the speedy retrieval and transfer of common items between locations.

13.59 We found cases of unnecessary duplication of stock. Lenses and bulbs for navigational aids were held in custodial stock, even though the same item was held in the Stores Revolving Fund bin a few feet away. Custodial stocks, which are held for future use, are building up at a significant rate. Money is being wasted because there is no effective supply planning and inventory control system. For example, an estimated $2 million would be recovered if the Department disposed of surplus inventory. Financial information is the key element of such a system.

13.60 Now that the Department has terminated the Stores Revolving Fund, there is an even greater need to improve depot organization and supply management through consolidating, collecting and rationalizing stocks and to improve the associated inventory management activities.

13.61 The Department states that the Materiel Management System currently being implemented will address some of the control difficulties that have existed and should provide the basis for improved inventory management. It also reports that concerted efforts are being made to reduce stock levels where demand has been reduced.

13.62 **The Department of Transport should rationalize inventory practices, redeploy or dispose of non-moving stock, establish inventory targets and develop procurement procedures that require the review of existing stock holdings across the national system prior to the purchase of new materiel.**

13.63 **Real property**. The Nielsen Task Force Report on Real Property estimated the replacement cost of the Department's extensive real property holdings, excluding parcels of land whose value is not known, as follows:

Airports	$ 7.5	billion
Coast Guard (navigation aids, bases)	.9	
Harbours and Ports (wharves, sheds)	1.0	
Other (training and test centres)	.1	
	$ 9.5	billion

13.64 Consolidated corporate financial information on the acquisition costs of real property exists for the major airports. A recent one-time study determined fixed asset and accumulated depreciation balances for the smaller Transport Canada airports. For capital assets held by Coast Guard, consolidated financial information is non-existent, although there are custodial records relating to land and buildings. There is no central, corporate focal point for fixed asset management. Corporate decision makers do not have all the information they need readily available, such as the holding costs of land, for decisions on property utilization and surplus disposals. In the case of the Department's extensive land holdings, although records exist, they are fragmented and not easily retrievable. There is incomplete historical cost or market information with which to estimate the value of the Department's holdings.

13.65 We found that in the Western region of Canadian Coast Guard, 27 per cent of the leases had expired and rents were being collected at the old rates, resulting in a significant loss of revenue. At the Ottawa International Airport, 379 hectares of land, some of which was surplus, were rented for $3,000 annually, yet the holding costs, including grants in lieu of taxes, were $174,340. A recent internal audit identified rental losses of at least $640,000 annually in Crown-owned housing caused by providing subsidized housing and long-term vacancies. At one site, 4 units had been vacant for an average of 17 consecutive months; at another site 17 units were vacant for an average of 28 months. One of these units had been vacant for 54 consecutive months at a cost of $75,000 in lost revenue.

13.66 The Department states that Commercial Plans for all airports have now been completed. They identify commercial development opportunities for marketable land as well as property surplus to airports' operational and commercial requirements. These Commercial Plans are being implemented. In addition, the Department reports that Industrial Park Plans are being developed for those airports with the greatest commercial potential.

13.67 In 1979, the Department developed and implemented a fixed asset accounting system. It was abandoned in 1984 when the Department found that the cost of accumulating, validating and entering the data exceeded the projected benefits. The development of a fixed asset accounting system has now been assigned a high priority and a new system is being developed. The Department states that a project is currently under way to develop a complete inventory of all properties. This will identify all real estate holdings including acquisition cost.

13.68 **In addition to developing an integrated fixed asset accounting system, the Department of Transport should develop a policy and organizational infrastructure, including a corporate focal point, that will enable it to improve control over its extensive fixed assets.**

Internal Accounting Controls

13.69 Since our 1974-76 audit, there has been an improvement in fundamental internal accounting controls over the thousands of routine revenue and expenditure transactions processed by the Department. Improvements include better segregation of duties and delegation of authorities. We found no significant accounting errors that would result in material distortion in the Public Accounts of Canada.

13.70 However, we found evidence of weaknesses in accounting controls over non-routine, complex accounting transactions between the Department and Crown corporations and within the Airports Revolving Fund. Incomplete or inaccurate information provided to management on these transactions adversely affects the Department's ability to hold these entities accountable for the funds provided.

13.71 The Department makes annual capital contributions to VIA Rail Inc. These payments, which were $122 million in 1985-86, are governed by terms and conditions approved by the Governor in Council. Our audit focused on the role of the Department's financial officers in analysing and approving these capital contributions. According to the Treasury Board Guide on Financial Administration, the Department is responsible for approving payments, setting up year-end accruals for amounts owed by VIA Rail to its suppliers for capital projects and ensuring the accuracy of the charges to the vote, as reported in the Public Accounts. In particular our review examined capital payments, and related accruals, for 1985-86 and 1986-87.

13.72 For the 1985-86 year end, the Department included in the Public Accounts of Canada a payable of $37.2 million for capital contributions to VIA Rail. The Guide on Financial Administration requires that such payables only be recorded when they can be substantiated and valued individually and when they can be individually identified with subsequent payments. The Department was unable to supply us with the required documentation by major capital project, such as contracts or suppliers' invoices.

13.73 We found that an amount of $22 million for acquiring locomotives was included in the 1985-86 year-end payable. At our request the Department obtained additional documentation from VIA Rail. Our analysis revealed that VIA Rail was not required to make any payments to the suppliers before delivery, which was scheduled to occur in December 1986. In fact the documents showed that, at 31 March 1986, VIA Rail's supplier had incurred estimated costs of only $7 million for these locomotives. Consequently $15 million of this year-end payable should not have been set up. Further, the Department did not match amounts paid against the individual amounts included in the original payable of $37.2 million. Rather it charged the payable with all subsequent monthly invoices received in the new year, until the entire payable was cleared. The establishment and liquidation of the payable contravened the relevant sections of the Guide on Financial Administration. We concluded that the payables set up at year end were misstated by at least $15 million for these locomotives.

13.74 We examined the financial controls over the administration of the Prairie Branch Line Rehabilitation Program. Our audit addressed the initial option analysis, formal progress reporting to Treasury Board and controls established to monitor performance.

13.75 The Prairie Branch Line Rehabilitation Project was established in 1977-78 as a $1.07 billion 12-year rehabilitation program for grain dependent railway lines. Details of our findings are a separate audit note in Chapter 3 of this Report. This case illustrates that because of the absence of good financial controls, such as an audit provision in a contribution agreement, there is no assurance the Crown will receive adequate value in return for surrendering for one dollar an option to purchase equipment that has an agreed value of $16.73 million.

Exhibit 13.7

CASE STUDIES IN SYSTEMS DEVELOPMENT

System	What Transport set out to do			What Transport achieved		
	Objectives	Completion Date	Initial Estimate	Result	Delivery Dates	Costs to date
Revenue						
Accounts receivable	National A / R system	1984 *	$260,000*	Information not timely	1985	$800,000
Billing, cash, reporting	3 National systems	Not estimated		No national systems	cancelled in 1984	$625,000
Project reporting						
Program information system - capital	Project planning (Air)	1982*	$110,000*	Non-integrated, monthly reporting system	1984	$380,000
Project cost accounting	Corporate project system	1984*	$353,000*	Corporate system cancelled		Not significant
Cost accounting						
Marine	Cost information for rate setting, justification and cost control	1985	$400,000	Not yet implemented		$600,000
Fixed assets	Validated information on marine fixed assets	1983*	N / A	Information gathering and validation cancelled 1984	N / A	EDP costs not significant
Materiel Management	Inventory management system	1983*	$821,000* $3,800,000**	System in place at 21 depots Annual operating cost $3,000,000	1987	$8,000,000
Personnel	Pay and personnel	1984*	$1,346,000*	Only partially implemented	1986	$5,343,000
RUSH	Consolidated financial information for Program Control Board	1985	N / A	System in place	1985	$120,000

* Goals and estimates as provided by the Department to the Comptroller General in October 1981.
** Revised internal estimates. Includes $1,200,000 for implementation.
N/A - Not available

13.76 Since 1980, we have commented on cases of failing to maintain proper records for the Airports Revolving Fund and the lack of reconciliations between control and subsidiary accounts. These have required a large number of adjustments in the consolidated financial statements. We have also been concerned with the quality of financial reporting. Initiatives are under way to improve financial accounting and controls within the Fund.

Financial Information Systems

13.77 Since our 1974-76 Financial Management and Control Study, there has been some progress in providing operational managers with the key financial systems and information needed to manage the many different lines of business that the Department is in. For example, the Resource Utilization Status Highlight (RUSH) report provides the Program Control Board with reasonable, timely, consolidated information on forecast expenditures and non-committed resources. There is an automated, integrated accrual accounting system at Pearson International Airport, and there are many locally-developed systems that meet local needs for financial information.

13.78 Significant investments of approximately $20 million have been made since 1982 to develop new financial systems. These have produced some improvements, but the systems in place are not yet providing adequate information for the complete range of financial management activities essential to support the Department's objectives for cost control, cost recovery and increased productivity. Exhibit 13.7 illustrates where much of this investment of $3 million to $4 million a year for developing financial information systems has been made.

13.79 The Department states that, finding itself in a catch-up situation, it was forced to undertake the implementation of a Financial System Master Plan in parallel with the introduction of a new Distributed Data Processing Network involving new technology. The interaction of these two major initiatives on the development of financial systems resulted in a high risk environment. Although we recognize the quantum leap in hardware and software technology, which resulted in a high risk environment for systems development, many of the cost overruns reveal a pattern of poor project management.

13.80 As illustrated in Exhibit 13.7, in the majority of instances where system development has been completed, it has taken much longer than originally anticipated and has cost far more than originally estimated. Other planned financial system development initiatives, such as the development of billing, cash and revenue reporting systems, have been cancelled or deferred. As a result, management in the Department still does not have the financial information that it has consistently identified as being important. The Department has estimated that it has a five-year backlog of requests for systems development.

13.81 In the case of the Materiel Management System, the cost of developing it will exceed the immediate savings the system may produce, until it is extended to all the Department's inventory holdings. The total development and implementation cost is $8 million; the Department originally estimated potential one-time inventory savings to be only half that amount. A comparison of the Materiel Management System's $3.2 million annual operating cost with the estimated annual operating savings of $1 million to $1.5 million shows that the system currently costs more to run than the direct benefits attributable to it, excluding nonquantifiable benefits such as improved safeguarding of assets. Project management for this ambitious project was weak. For example, there were four different project managers during the first four years of the project. No project budget was established at the outset. Project costs were not formally reported, variances were not formally controlled. There were also setbacks caused by several changes in computer equipment and software that were unforeseen at the design phase of the project.

13.82 We noted cases of duplication of effort in systems development. For example, there is a department-wide need for project management systems to help manage the hundreds of millions of dollars spent annually on capital projects. To meet this need, the Department developed at least three departmental systems and procedures to assist managers in planning and managing projects at various levels. However, these initiatives generally evolved independently of one another and, as a result, there were some inefficiencies such as a duplication of systems development efforts, a duplication of data in the various systems, difficulties in reconciling information in the systems, and duplication of data entry. There is still no consolidated corporate system for project reporting and there is a need to integrate the outputs of these individual systems into a format that serves the needs of corporate management.

13.83 The Department of Transport should re-examine its approach to developing and implementing financial management information systems and should ensure that:

- **the organization of the data processing function encourages the development of efficient and effective systems, makes the best possible use of available resources and establishes clear accountability for project management;**
- **large national systems are developed with realistic budgets and timetables and ensure that other methods of obtaining the needed information, such as regionally developed systems, are assessed before system development commences; and**
- **project management is improved by better controls over significant changes in user specifications, better monitoring of projects including the use of variance reports, improved progress reporting and better evaluation of completed projects.**

13.84 The Department of Transport's Program Control Board should review all major new national systems before they are implemented.

Accountability Reporting

Full Financial Disclosure

13.85 **Airports Revolving Fund.** We noted a significant improvement in the Fund's annual financial statements. They now include all the readily attributable costs of the Fund's operations, including interest costs associated with assets contributed by the government and services provided by other government departments.

13.86 **"At and East" subsidy.** Under section 272 of the Railway Act, a program commonly referred to as the "At and East" subsidy program was enacted in 1965 to encourage the continued use of eastern Canadian ports for exporting grain and flour. In 1984, the Canadian Transport Commission completed an evaluation study of the At and East Grain and Flour Subsidy Program. The study found that the subsidy encouraged shippers to favour those routes that qualify for the At and East subsidies over lower cost and more efficient transportation alternatives. Our examination confirmed this conclusion. For example, we found that shippers were sending grain from Thunder Bay to eastern Canadian ports, which met the objectives of the At and East program. However, rather than using rail routes or inland waterways direct to the eastern ports, the subsidy encourages shippers to select combined ship and rail routes in order to qualify for the At and East subsidy. The objectives of the subsidy program are met, but the resulting inefficient use of the transportation system is contrary to the objectives of the National Transportation Act.

13.87 As another example, the evaluation study stated that shippers in Southern Ontario with grain destined for eastern ports were sending the grain westward first, to an inland point that qualified under the At and East program for subsidized rates. The grain was then reshipped eastward. Although the Canadian Transport Commission was aware that the subsidy program was resulting in unintended effects and was subsidizing inefficient transportation methods, this information had not been reported to Parliament through Part III of the Estimates. We comment further on this subsidy in the Subsidies section of this chapter.

13.88 We also found that payments made to railway companies under this program are calculated on the basis of compensatory rates that reflect outdated railway costs. Railways are eventually compensated for the difference between outdated and current costs once they submit new cost submissions. This process can take several years. For example, subsidy payments made in 1986-87 were based on 1982 railway costs. The additional payments for the period 1982-87 that are expected to be made when the reconciliation process is completed are estimated by the Canadian Transport Commission at $11.3 million. This estimated liability has not been individually disclosed to Parliament.

13.89 **MFRA/ARFAA subsidy.** Enacted in 1927 and 1969 respectively, the Maritime Freight Rates Act (MFRA) and Atlantic Region Freight Assistance Act (ARFAA) provide subsidies on freight shipments that originate within a designated select territory and are destined to other points in the select territory or to points in Canada west of the select territory. In some cases, these subsidies are also restricted to eligible commodities. We found that because of deficiencies in the controls over eligibility for this program, applications for subsidies were being submitted to the Minister without information on the estimated total potential cost. For example, in January 1987, five more commodities became eligible for subsidies. The Regulatory Impact Analysis Statement published in the *Canada Gazette* about this subsidy approval stated that "the impact of this action will be a reduction of about $100,000 to the transport costs to these industries". We found that the amount of $100,000 refers to the estimated liability to be incurred in subsidizing just the five applicants for the subsidies, even though all other manufacturers of these commodities are now eligible for subsidy. The Department has not estimated the potential number of eligible manufacturers created by the approved subsidies. Similarly, no amount has been estimated for payments to potential applicants in addition to those who specifically applied in the first instance.

Subsidies

"At and East" Grain and Flour Subsidy Program

13.90 The "At and East" subsidy program was established to encourage the continued use of eastern Canadian ports for the export of grain and flour. An eastern port is defined as any of the ports of Halifax, Saint John, West Saint John and certain ports on the St. Lawrence River from Montreal east. Rates for grain moving in bulk to any eastern port from specified inland points were frozen at the 30 November 1960 level. Rates on flour were frozen at their September 1966 level.

13.91 In the earlier section on Accountability Reporting, we noted that an evaluation study of this program had been completed in 1984. This study found that the subsidy encouraged shippers to favour routes that generated At and East subsidies over lower cost and more efficient transportation alternatives. Although we agreed with this conclusion, we found that the evaluation was limited in two respects. It assessed the operation of the program, but it did not measure the achievement of its stated objective. In particular, it did not measure whether flour and grain moving through Montreal and other eligible ports would have done so in the absence of the subsidy. Neither did the study examine whether the range of ports eligible for the subsidy is consistent with the underlying intent of the legislation. For example, the study failed to address whether it is still necessary to subsidize shipments through St. Lawrence River ports as well as Atlantic ports. Since the program is more than 20 years old, spanning a period of considerable change in transportation systems, there is a significant need to evaluate whether the original justification for the program and the means by which its objectives were to be achieved, are still valid.

13.92 Although Transport Canada and the Canadian Transport Commission became aware, as a result of the evaluation study, that the subsidy program had a number of unintended effects that were contrary to the National Transportation Act objectives of "making the best use of all available modes of transportation at the lowest total cost", they did not undertake an analysis of program alternatives that would diminish the unintended effects and inefficiencies.

13.93 We further found that the claim verification procedures used by the Canadian Transport Commission needed strengthening to ensure that ineligible or excessive claims were not approved. We noted that claims were being paid without a review of supporting documentation such as waybills, shipping orders, bills of lading, receipts for grain elevator charges or proof that shipments met the program's statutory eligibility requirements.

Maritime Freight Rates Act and Atlantic Region Freight Assistance Act Programs

13.94 These Acts provide subsidies on freight shipments that originate within a designated select territory and are destined to other points in the select territory or to points in Canada west of the select territory. These Acts authorize three distinct subsidy programs in the Atlantic Region. The basic west-bound program applies to virtually all commodities. It subsidizes west-bound shipping costs by 30 per cent for the portion of the route within the select territory. The selective west-bound subsidy provides an additional reduction of 20 per cent, but commodities must qualify for eligibility. The intra-territory program is also applied selectively and subsidizes eligible shipments between points in the select territory by 10 per cent.

13.95 **Control over eligibility.** Under the eligibility control process, an entire commodity class is deemed eligible for the 50 per cent combined basic and selective west-bound subsidies, on the basis of information supplied by a single manufacturer within the class (the applicant). We found that there was little attempt to ensure that applicants are generally representative of manufacturers in their class. For example, a criterion applied in the selection process is whether the commodity has achieved maximum "value-added" potential in the select territory (a measure of economic development). Although value-added information supplied by the individual applicant is reviewed, no effort is made to find out whether the information is representative of all the other companies that automatically become eligible for subsidy if the application is approved.

13.96 We also found that commodities are routinely added to the programs but no process exists for identifying commodity subsidies that no longer meet the eligibility criteria.

13.97 **Program administration.** The Canadian Transport Commission informs us that there is inadequate precision in the wording of the appropriate regulations designed to express the intent of the legislation concerned. For example, exemption clauses in the regulations state that the intent is not to assist freight movements by overland routes to U.S. markets. Information available to the Canadian Transport Commission, however, suggests that commodities such as peat moss, powdered milk, potatoes and particle board have moved under the west-bound assistance programs to destinations such as Windsor and Niagara Falls where they are stored and re-shipped to the United States.

13.98 In another case, the intra-territory regulations prohibit paying subsidies to trucking companies owned by the shipper. Studies by the Commission suggest, however, that this prohibition has been circumvented by a number of trucking companies. According to Commission estimates, approximately 150 trucking companies receiving the intra-territory subsidy in 1984 displayed some corporate inter-relationship with a principal shipper. Such parties received $6.8 million of the intra-territory subsidy in 1984-85, or approximately 25 per cent of total intra-territory subsidies and 32 per cent of intra-territory subsidies to trucking companies.

13.99 We also found anomalies in the classification system used to list eligible commodities. For example, the definition of "value-added" is inconsistent with that used by

Statistics Canada. This makes it difficult or impossible to carry out the commodity analysis that is needed to judge the representativeness of individual applicants.

13.100 **Effectiveness evaluation.** A full evaluation of the MFRA/ARFAA programs has not been performed to assess whether the subsidies paid are achieving the objectives of the program or whether there are unintended effects resulting from the payment of the subsidies.

13.101 **Transport Canada and the Canadian Transport Commission should:**

- **analyse program alternatives to diminish unintended adverse effects and inefficiencies of the At and East Grain and Flour Subsidy Program;**
- **improve the claim verification process for At and East claims;**
- **carry out an evaluation of the Maritime Freight Rates Act and Atlantic Region Freight Assistance Act program and re-evaluate the At and East program by considering whether its objectives are being achieved and whether the original justification for the program is still valid; and**
- **improve administrative controls over the MFRA/ARFAA subsidy, including controls over program eligibility and better monitoring of adherence to program regulations.**

Western Grain Transportation Act Program

13.102 The Western Grain Transportation Act authorizes the Canadian Transport Commission to establish railway freight rates for the movement of western grain destined for export. Since rates are established before the start of the crop year, they must be determined on the basis of forecasts. Railway cost forecasts are prepared by the Canadian Transport Commission; forecasts of the volume of grain to be shipped are developed by the Grain Transportation Agency. Under the Western Grain Transportation Act, the volume forecast is required by 28 February each year. The Canadian Transport Commission combines the two forecasts to determine the rate scale. The accuracy in any given year of subsidy payments under the Western Grain Transportation Act therefore depends on the accuracy with which officials forecast the volume of grain to be transported in the following year. Variations between forecast and actual grain shipments can result in significant over- and under-payments by shippers, and correspondingly, under- and over-payments of subsidies by the government. Although there is a self-correcting mechanism built into the legislation, flaws in the forecasting process could result in variances that exceed the limits of the self-correcting mechanism.

13.103 We found the forecasting process could be strengthened in a number of respects:

- As a result of the 28 February statutory deadline, the Grain Transportation Agency does not have access to the required crop information for the forecasting year. Current information on farmers' planting intentions could improve the accuracy of the forecast.

- The Agency had made some technical errors in using statistical methodology. It has informed us that, subsequent to the audit, these errors were corrected.
- The Agency is using one forecasting methodology that produces a forecast dispersed over a wide range. Further testing of alternative methodology is required to determine whether better estimates could be produced.
- The Grain Transportation Agency forecasts provide one number, rather than a range that would more comprehensively depict the outputs of the forecasting process. The Agency states that this approach makes it easier for the Canadian Transport Commission to calculate the freight rate. In our opinion, the disclosure to decision makers of the variance (range) within which the forecast lies would permit a better appreciation of the limitations of the forecast.

13.104 The Grain Transportation Agency should seek a technical amendment to the Western Grain Transportation Act to advance the date of publication of the forecast to the spring when better information on planting intentions is available.

13.105 The Grain Transportation Agency should examine other forecasting approaches to determine whether the forecast variance (range) can be reduced.

13.106 The Grain Transportation Agency should disclose the variance (range) associated with its statistical forecast.

Major New Initiatives

13.107 *The Department reports that it has a number of major new initiatives under way that address many of the concerns expressed in this Chapter. Many of these have already been mentioned. The significant ones are summarized in Exhibit 13.8.*

13.108 *The Department intends to deal with most of the major deficiencies noted in this chapter through the initiatives listed in Exhibit 13.8. We would expect the Department to monitor and regularly report to senior management on their implementation. We will follow up and report on this in future audits, and we will also follow up on the extent to which these initiatives have overcome the identified deficiencies.*

Exhibit 13.8

MAJOR NEW INITIATIVES

Initiative	Description	Target Date
Planning / Budgeting		
Performance indicators	Assess indicators for short and long-range aids to navigation and waterways development in Marine, develop performance indicators for the Aviation Group and for the financial function	December 1987
Cost recovery policy development	Cost recovery guidelines and policies for Airports, Aviation and Marine	June 1988
Airports Program Control Boards	Regional boards to review and challenge capital projects and re-allocation proposals	September 1987
Operations		
Fixed assets policy	Revised policy and definitions for fixed assets	December 1987
Billing system	Develop and implement computerized billing system	December 1987 (first phase)
Targets for collection activity	New objectives to improve collection performance	December 1987
Commercial property management implementation project	Implement a new commercial property management regime	October 1987
Commercial accounting for major airports	Implement a system for accrual accounting at major airports	April 1988
National materiel management system	An automated materiel management system, which will include $200 million of inventory	September 1987
Asset financial management	Develop and implement an integrated fixed asset accounting system, including a system to record the cost of land, buildings and works	March 1988
Accountability Reports/Results		
Level of service standards	Quality of service standards for Aviation and Marine	Fall of 1988

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION

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14

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION

Overview

14.1 In 1977, the law governing employment and immigration brought together the Department of Manpower and Immigration and the Unemployment Insurance Commission to form the Canada Employment and Immigration Department/Commission.

14.2 The Commission is responsible for all employment, unemployment insurance and immigration programs. The Department is responsible for strategic policy and planning and for public affairs.

14.3 The Commission's activities are carried out through a decentralized structure of 10 regional offices and some 800 temporary, mobile or permanent local service offices. The Commission uses approximately 24,000 person-years annually.

14.4 In addition to its chairman and vice-chairman, the Commission has two commissioners who represent workers and employers in developing, approving and implementing programs that affect them. The Commission operates three programs: Employment and Insurance, Immigration, and Corporate and Special Services. The objective of the Employment and Insurance program is to develop and apply a framework of policies and programs necessary for the efficient functioning of the Canadian labour market. It consists of four activities, including Human Resource Development programs of which the Canadian Jobs Strategy is a part.

14.5 In 1986-87, Employment and Immigration Canada spent $6.2 billion. Exhibit 14.1 shows how the funds administered by the Commission and the Department were distributed in 1986-87. Under Employment and Insurance grants and contributions, 99 per cent of the expenditure was for the Canadian Jobs Strategy.

Audit Scope

14.6 In Chapter 6 of our 1986 Report, we reported on the job creation and training programs in effect at that time. This year's chapter deals with our audit of the Canadian Jobs Strategy, introduced by Employment and Immigration Canada in September 1985.

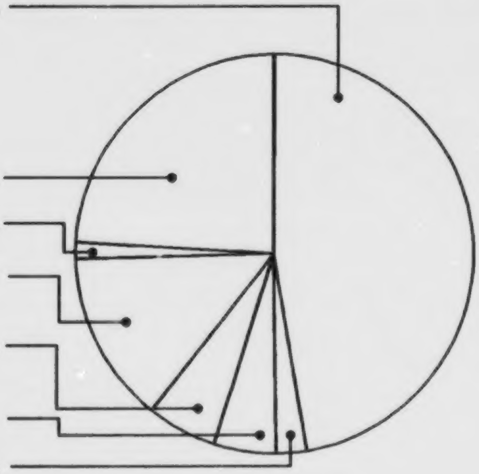
14.7 The audit covered fiscal years 1985-86 and 1986-87 and examined these areas:

- planning and implementing the new Strategy;
- putting the Strategy and its associated activities into operation;
- procedures for measuring results; and
- information for Parliament.

Exhibit 14.1

EMPLOYMENT AND IMMIGRATION CANADA DISTRIBUTION OF EXPENDITURES FOR THE FISCAL YEAR 1 APRIL 1986 TO 31 MARCH 1987 (millions of dollars)

Contributions to the Unemployment Insurance Account and Fishermen's Benefits	$ 2,912.0	47.3%
Employment and Insurance:		
Grants and Contributions:		
Human Resource Development Program	$ 1,479.0	24.0%
National Employment Services	$ 80.0	1.3%
Operating Expenditures	$ 866.0	14.1%
Payments under sections 37, 38 and 39 of the Unemployment Insurance Act	$ 348.0	5.7%
Corporate and Special Services	$ 310.0	5.0
Immigration	$ 161.0	2.6%
Total	$ 6,156.0	100.0%



Source: Public Accounts 1986-87.

Note: Includes administrative costs charged to the Unemployment Insurance Account ($945.7 million). It does not include benefits paid in the amount of $10,173.8 million from the account except those paid under sections 37, 38 and 39 of the Unemployment Insurance Act and the Contributions to the Unemployment Insurance Account and Fishermen's Benefits.

14.8 The full implementation of the Canadian Jobs Strategy programs is still going on. We will audit the programs again when they are more firmly established.

14.9 Our examination covered Headquarters and regional offices in Nova Scotia, Quebec, Ontario, and British Columbia.

14.10 In the four regions, we audited a total of 128 contribution agreements started during the Strategy's first 12 months of operation. We selected a stratified random sample of 100 contribution agreements in Quebec and Ontario. We also examined another 28 high monetary value contribution agreements from all four regions. We verified whether Employment and Immigration Canada had complied with authorities, guidelines and directives in the selection of proposals, their assessment, approval and monitoring for the nine options with the largest expenditure in the five programs that had started in September 1985.

14.11 Employment and Immigration Canada was also part of the Financial Management and Control Study reported in Chapter 4. We examined and evaluated Employment and Immigration Canada's planning and budgeting systems, the management and financial controls in place and internal and external reporting. We also reviewed the Employment and Immigration Information System and the role of the financial function. In the Unemployment Insurance activity, we examined and evaluated the linkages of the objectives with the statement of results and the measures of performance.

Background

14.12 In September 1985 Employment and Immigration Canada launched the Canadian Jobs Strategy, a series of new programs to provide jobs and skills to Canadians. Its focus was on clients most in need of support, long-term unemployed people, youth making the transition from school to work, women re-entering the labour market, workers needing skills training to avoid layoffs or job displacement, and workers in communities suffering severe economic decline. The first year, 1985-86, was a year of transition in federal labour market programming. Employment Training and Direct Job Creation programs were being gradually phased out as the Canadian Jobs Strategy programs became operational. While implementing the new Strategy, the commitments made under the previous labour market programs were rolled into the Strategy programming.

14.13 Exhibit 14.2 shows the objectives, options and clientele for the six programs of the Canadian Jobs Strategy. The Canadian Jobs Strategy was presented as an integrated approach to intervention in the labour market. Each of its programs was to address a specific clientele (for example, Job Entry for unemployment youth entering or women re-entering the labour force) or a particular problem in the labour market (for example, Skill Shortages to assist employers to meet their needs for skilled workers in short supply).

14.14 Each of the programs, with the exception of Innovations, which is a program designed to provide financial assistance for projects that test new solutions to labour market problems, have options that comprise the purchase of training in institutions only. Other options provide grant and contribution agreements for other kinds of program activity in a variety of sectors such as secretarial services and office management, forestry and horticulture, mechanics, insurance, and computer programming. In 1986-87, 407,388 Canadians participated in these programs.

14.15 In 1985-86, a total of $1.43 billion was spent – $1.29 billion on old programming and $.14 billion on new programming. There was a total of 470,500 participants in old and new programs in 1985-86, including 41,200 participants in the Canadian Jobs Strategy.

14.16 Exhibit 14.3 shows the expenditures and the number of participants for 1985-86 and 1986-87. In both years the largest program expenditure in the Strategy was for Job Development. In the first year, 68 per cent of new Canadian Jobs Strategy programming was spent on Job Development Programs and 54 per cent was spent in the second year.

Exhibit 14.2

THE CANADIAN JOBS STRATEGY
Programs, Objectives, Clientele and Options
February 1987

PROGRAMS	JOB DEVELOPMENT	JOB ENTRY	SKILL SHORTAGES	SKILL INVESTMENT	INNOVATIONS	COMMUNITY FUTURES
Objectives	• to assist the long-term unemployed to participate effectively in the labour market.	• to assist persons having difficulty making the transition from school or home to the labour market.	• to assist employers find skilled workers, in skills that have been designated as in shortage.	• to assist persons whose employment is subject to change or elimination.	• to stimulate and support innovative labour market initiatives.	• to assist communities and workers adapt to serious labour market problems.
General Eligibility Criteria for Clientele	• unemployed for 24 out of the last 30 weeks	• unemployed youth • women out of the labour force for three years • secondary and post-secondary students	• current and newly hired workers • unemployed workers	• employers, firms • employee or employee associations	• individuals or organizations not funded by the federal government	• non-metropolitan communities in greatest need
Options	• General Projects • Individually Subsidized jobs • Severely Employment Disadvantaged Projects • Direct Purchase of Training • Indirect Purchase of Training through Groups	• Entry • Re-entry • Cooperative Education • Summer Employment/ Experience Development • Work Orientation Workshops • Direct Purchase of Training • Indirect Purchase of Training through Groups	• Work Place-based Training • Relocation and Travel Assistance • Direct Purchase of Training • Indirect Purchase of Training through Groups	• Training Trust Fund • Extended Training Leave • Small Business Training • Section 37: Work Sharing • Industrial Adjustment Service • Direct Purchase of Training • Indirect Purchase of Training through Groups	• No separate options	• Community Futures Committees • Business Development Centres • Self-employment Incentive • Relocation Exploratory Assistance • Community Initiatives Fund • Direct Purchase of Training • Indirect Purchase of Training through Groups

Exhibit 14.3

THE CANADIAN JOBS STRATEGY
EXPENDITURES AND NUMBER OF PARTICIPANTS
1985-86 AND 1986-87
(in thousands of dollars)

	1985-86			1986-87
	New Programs	Old Programs	Total	
Job Development	96,170	230,397	326,567	834,170
Job Entry	30,703	148,823	179,526	345,924
Skill Shortages	5,193	54,530	59,723	185,017
Skill Investment	7,322	-	7,322	48,800
Innovations	2,142	-	2,142	14,755
Community Futures	-	68,341	68,341	64,117
Institutional Training	-	686,879	686,879	-
Other	-	101,376	101,376	50,022
Total Expenditures	141,530	1,290,346	1,431,876	1,542,805
Total Participants	41,200	429,300	470,500	407,388

14.17 Proposals for funding are made and, if approved, are carried out by third parties such as employers, sponsors or co-ordinators. Places in training courses are purchased from the provinces and territories and are generally provided by public training institutions. Participants that meet the program eligibility criteria are referred to approved proposals or purchased training either by Employment and Immigration Canada or by other organizations, subject to verification by the Commission.

14.18 In 1986-87, $1.5 billion was spent on Canadian Jobs Strategy programs. A total of $655.8 million, or 42.5 per cent of 1986-87 expenditures on the Strategy, went for purchasing training courses direct from the provinces and territories and for trainees' allowances. The balance, $887 million or 57.5 per cent, was spent mainly on contribution agreements with third parties.

Development of the Canadian Jobs Strategy

Early Development

14.19 In the fall of 1984, the government initiated a review of federal labour market policies that resulted in the announcement of the Canadian Jobs Strategy on 27 June 1985 (see Exhibit 14.4). Employment and Immigration had prepared an inventory of possible program options that was used as background in developing the eventual Canadian Jobs Strategy. In addition, a series of analyses had been conducted of available labour market studies, past programs and statements made by public officials and political parties.

14.20 In the 8 November 1984 economic statement, the Minister of Finance outlined the directions for change in employment development and training to ensure that they were

Exhibit 14.4

TABLE OF EVENTS
DEVELOPMENT OF THE CANADIAN JOBS STRATEGY

1984	November	8	- Economic Statement
	December		- Consultation Paper on Training
1985	January		
	February	14 and 15	- First Ministers' Conference
	March		**Concept papers**
	April		
	May	23	- Budget
	June	13	- Treasury Board Approval
		27	- Announcement of Canadian Jobs Strategy
	July		**Finalization of Operational Tools**
	August		
	September	5	- Launch of Canadian Jobs Strategy

delivered more effectively than in the past. For employment development, a review would be initiated that would simplify programs and ensure that the prospects for the less advantaged were enhanced. Training was identified separately as requiring a review of federal programs to assess whether the real needs of the labour market were being met, the responsibilities of the private sector were adequately recognized and supported and training was sufficiently innovative and flexible. An intention to fund employment and training programs in 1985-86 for an additional $1 billion was announced. At the same time, the funding of the old General Industrial Training program was reduced by $40 million.

14.21 Employment and Immigration Canada released a Consultation Paper on Training in early December 1984. It discussed ways that the Government of Canada could best meet its obligations in training and skills development. Different options were presented for discussion.

14.22 During December 1984 and January 1985, the Minister of Employment and Immigration met with her counterparts in the provinces and territories, and with representatives of business, labour and other organizations. Through this consultative process, agreement was reached on the underlying principles of a new labour market strategy, which was announced at the First Ministers' Conference on the Economy in Regina on 14-15 February 1985. Additional funds of $695 million for training and employment and $205 million for summer programs were to be made available to implement the new Strategy. The changes were considered far reaching and were expected to take several years to implement fully.

14.23 The five basic principles as announced were:

- to emphasize support of small business and entrepreneurship;
- to be responsive to regional and local needs through flexible and innovative programming;
- to share responsibility for training and employment development between governments and the private sector;
- to facilitate equality of access; and
- to provide simple, understandable programs that avoid duplication.

14.24 Six major thrusts, which eventually became programs under the Canadian Jobs Strategy, were also announced. These programs were intended to avoid the confusing array of past programs. The new Strategy was designed to improve the government's response to labour market problems by linking job creation, work experience and training. New data and monitoring mechanisms were to be established and, to provide a better basis for planning, long-term commitments to funding were to be made instead of the stop-go financing of the past. In line with its mandate of encouraging equity in the labour market, Employment and Immigration Canada was to set participation targets for women, Native people, disabled people, and members of visible minorities. Local Advisory Councils were to be a new vehicle for obtaining local advice.

Financial Analyses of Recommended Options

14.25 The months after the First Ministers' Conference were spent on further consultations and on developing the concepts. These consultations lasted until June 1985 and involved provincial representatives, the business community, trade unions and public and private organizations. The emphasis in the new Strategy was on supporting activities for those most in need and funding what would work best. As a result, some activities that had been funded in the past were dropped and others were reduced in scale. For example, evaluation studies conducted by Employment and Immigration Canada had shown the ineffectiveness of short-term job creation programs.

14.26 There was continuity with past programming in some features of the Strategy. A pilot program for youth, Youth Training Option, served as the basis for the Job Entry program. In addition, elements of past programs were used in developing the Skill Shortages program from the former Critical Trade Skill Training program, Projects for the Severely Employment Disadvantaged in Job Development from the former Job Corps, General Projects in Job Development from the former Canada Works, the Business Development Centre option in Community Futures from the former LEAD Corporations.

14.27 On 23 May 1985, the Minister of Finance confirmed the announcement by the First Ministers that an additional $900 million would be allocated for each of the fiscal years 1985-86 and 1986-87 to get the programs off the ground and operating more quickly.

14.28 Our objective was to determine whether financial analyses had been carried out in the development of the Canadian Jobs Strategy programs and options to ensure that expenditures would be made with due regard to economy. The introduction of a major new initiative in programming should be based on formal financial analysis. We asked to see the financial analysis used in comparing the recommended approach with alternatives in terms of the selected programs and options and the way they were put together in the Strategy.

14.29 Employment and Immigration Canada told us that, because the Canadian Jobs Strategy differed so widely in terms of objectives from other options or, indeed, previous programming, there was no valid basis for a comparative analysis for many of the options. During the course of discussions, Employment and Immigration officials expressed the view that traditional financial analysis of alternative program options would have been inappropriate in the environment in which the Strategy was conceived and announced. They pointed out that the context in which the Strategy was developed was one in which the new government had a clear vision of the directions it wanted to pursue

14.30 In our opinion, given that Employment and Immigration Canada has long standing experience in employment and training programs and given continuity with past programming, some valid basis did exist to perform formal financial analyses of the recommended approaches. New major initiatives involving hundreds of millions of dollars should be supported and justified so that the value to be obtained can be clearly identified.

14.31 Although no formal financial analysis was done, some work on unit costs was carried out by Employment and Immigration Canada. On 13 June 1985, Treasury Board approved the terms and conditions of five of the six Strategy programs and made available an amount of up to $780.1 million for labour market programs, of which $482.3 million was approved for new Strategy programming. At the same time, it expressed the concern that the new Strategy programs would involve high cost per participant, with a consequent lower number of beneficiaries of the various programs. We requested the analysis of costs per participant carried out before terms and conditions of the programs were approved. Although we were provided with some data on unit costs, the information, provided without supporting analysis, did not allow us to assess Treasury Board's concern.

14.32 **To ensure that expenditures will be made with due regard to economy, Employment and Immigration Canada should conduct formal financial analyses of alternative approaches when it is developing a new initiative.**

Employment and Immigration Canada's response: *In Employment and Immigration's view, formal financial analyses of alternatives apply mainly to those cases where there are a number of different and apparently reasonable alternative routes to meeting the program objective, and where the policy decision is to choose among the alternatives. Given that the strategic approach was to expand, not narrow, the alternative means that are available to meet the objectives of the Strategy, there was no need to choose from a list of reasonable alternatives at the outset. The intention was to include all the alternatives that were reasonable and feasible to implement in the time available. The longer-term intent was to increase flexibility by adding to the list of reasonable alternatives, through such mechanisms as the Innovations Program. The choice among the various alternatives was not to be determined in advance at the national level using some form of formal financial analysis, but at the regional and local level on the basis of what would work best. Increasingly, the results of follow-up surveys will provide real measures of success on which to base the choice of alternatives.*

For similar reasons, unit cost analyses were not relevant. Employment and Immigration officials have excellent knowledge of the costs of specific options and their expertise was brought to bear in the design of the initial package of Canadian Jobs Strategy options. Because the objectives and clientele of the Canadian Jobs Strategy differed so widely from those of former programs, global comparison of unit costs of the new options with earlier programs would not have been meaningful. For example, under Job Development, the objective is to provide skills needed to allow the long-term unemployed to find permanent work. The objective of former programs such as Canada Works was on the creation of short-term jobs for a much broader labour market group.

Implementation of the Canadian Jobs Strategy

14.33 After the principles were agreed upon with the provinces at the First Ministers' Conference, the consultation process continued. In February 1985, Employment and Immigration Canada established a steering committee on the development of the Strategy. It was to provide advice and guidance on the development of the components of the Strategy and on the continuing negotiations with the provinces. Six concept papers were completed by April 1985. On 13 June 1985, Treasury Board approved the terms and conditions for five of the six programs of the Canadian Jobs Strategy. The details for the Community Futures program, designed to assist communities and workers to adapt to serious labour market problems, were to be announced in the fall.

14.34 On 27 June 1985 the Minister announced the details of the Strategy, comprising six major programs that, for the first time, brought together training and employment development. All the programs were to start in the summer and the Strategy was to be fully operational by September 1985.

14.35 Starting in mid-May 1985, a series of work groups was established to plan the implementation of the programs and their options. Since the terms and conditions were not approved until mid-June 1985, only two and half months remained to finalize the programs and to put the Strategy into operation (see Exhibit 14.4). The details of each program were developed by a separate work group, including the design of their own work instruments such as forms, guidelines and directives. The groups worked at different speeds. The operational tools for Job Entry, for example, were ready by the end of the summer, but those for Job Development were not completely ready.

14.36 As the programs were being developed in further detail, various delivery mechanisms were designed. The 6 programs ended up with a total of 19 options. In turn, many of these options had their own forms, guidelines and directives.

Launching the Canadian Jobs Strategy

14.37 The official launch of the Canadian Jobs Strategy took place on 5 September 1985. The implementation of the Community Futures program was further delayed. Training purchased in institutions was not to be integrated into the Strategy until 1986-87.

14.38 Employment and Immigration Canada considered the changes made in Canadian Jobs Strategy programming to be fundamental and far reaching. To facilitate the implementation of such extensive change, staff responsible for program delivery required the supporting tools, such as forms, guidelines and directives.

14.39 We noted in our audit of the regional offices that there were problems with the availability of new forms at the time of program start-up. Where Job Development projects were "fast tracked" to start in July for fisheries and forestry, the new forms were not available. For the two Job Development options, general projects and projects for severely employment disadvantaged, the forms arrived late and, as a result, regional forms were developed or draft forms were photocopied. In Ontario, for example, claim forms were received on January 1986 for general projects; the guide to employers for general projects was received in October 1986. There were no instructions on how to complete the forms when they arrived. In British Columbia for general projects, payroll and attendance records and receipts and disbursement forms were regionally produced since they had not been received from headquarters.

14.40 New forms required in the approval process for Job Development contribution agreements were sent to the regions in draft form late in October 1985. These included the priority of proposals form, recommendation for approval form and non-concurrence form to be used in the case of lack of support from the Member of Parliament during his or her review of the proposals.

14.41 Given the short time for implementing the Strategy and given some operational difficulties in starting up, we believe that the personnel responsible for program delivery did the best they could in the circumstances. Their experience with earlier programs enabled them to turn to the work instruments and procedures that were in place before the Canadian Jobs Strategy. For example, 13 out of the 14 contribution agreements we audited in the option for the severely employment disadvantaged, had been initiated 2 to 15 years ago under former programs, and had been renewed under the Strategy because they were eligible under its criteria.

For each of the past three years, the project has helped about 60 unemployed young people enter the work force, at a cost of about $6,000 per participant (see paragraph 14.41).

14.42 Our audit of contribution agreements that covered nine options in the programs that started after September 1985 showed generally that the approval of proposals, the contribution agreements and payments were duly authorized at the appropriate level.

14.43 Our examination showed that local and regional personnel had to adjust to not having all the guidelines and forms at the beginning of the implementation period and to the ongoing changes that took place during the first year. Although the majority of the files we audited were complete, 40 per cent of the contribution agreement files mainly for Job Development were incomplete and did not contain all the information necessary for thorough analysis at the time of selecting a proposal for approval. For example, they didn't include documentation on continuing employment potential for the option – individually subsidized jobs – or on local labour market needs, or on complete training plans. Consequently, Employment and Immigration Canada cannot give assurance that all proposals for Job Development were selected and approved in accordance with program objectives or that all participants were eligible.

14.44 Of the files audited, 78 files were from all three options of Job Development. We noted problems in some of these files in meeting the requirement for sponsors to present training plans in their proposals. Yet these proposals were approved and subsequently funded. In our sample in Ontario and Quebec, 38 per cent of the 78 approved contribution agreements that required a training plan (44 per cent in Quebec and 31 per cent in Ontario) did not include all the information necessary such as objectives and description of the training or qualifications of trainers or a schedule of training.

14.45 Where the files were incomplete, Employment and Immigration Canada could not conduct the required analysis for approving proposals. In those cases, the quality of follow-up suffered, especially on training. For half the projects in Quebec, for example, the follow-up information in the file gave no assurance that the training that had taken place was the training that had been approved when the project was funded.

14.46 In Job Development, authority for determining and monitoring the eligibility of participants was not clearly defined when organizations outside Employment and Immigration Canada were involved. For example, in the case of the option for the severely employment disadvantaged, we found that for 7 of 14 cases audited, there was no documented delegation of authority to third party organizations for determining eligibility. In those same cases there was no subsequent monitoring by Employment and Immigration Canada.

14.47 There was a lack of documentation that would ensure that participants met the eligibility requirements of the Job Development program. The client information form was not signed by the participants to attest that the information used to determine their eligibility was correct – that they had in fact been out of work for 24 of the past 30 weeks.

14.48 **To ensure that projects comply with program directives, Employment and Immigration Canada should:**

- **ensure that all the information necessary for a complete analysis is available at the time of project selection, such as complete training plans;**
- **establish formal procedures to define the authority for determining and monitoring the eligibility of participants when outside organizations are involved; and**
- **amend the client information form to include a signature from each participant attesting to his or her eligibility at the time of admission to the program.**

Employment and Immigration Canada's response: *EIC followed a phased approach to launching the Canadian Jobs Strategy. The implementation process drew on the considerable experience acquired by the program staff over time, as well as on existing systems and work instruments. New forms, administrative guidelines and information systems are being developed as the Strategy evolves.*

In this process, there were some situations in the initial stage where documentation was incomplete. EIC is confident, however, that most problem situations which were identified during the audit have been rectified in the course of time. Moreover, the new on-line computer system that is currently being designed will result in a greater capacity to ensure that the selection and operation of Canadian Jobs Strategy activities are done with accuracy and completeness.

EIC agrees to review the areas identified in the recommendation in light of associated resource and administrative implications, and make any appropriate adjustments.

Slow Start-up

14.49 As shown in Exhibit 14.3, Job Development was the Strategy program with the largest expenditure in 1985-86. Job Development projects were assessed by regional personnel. Recommendations were made to Headquarters, with the written concurrence or non-concurrence of the Member of Parliament concerned, for final approval by the Minister. As the Minister had announced, each project was to combine training and work experience.

14.50 Exhibit 14.5 is based on Employment and Immigration Job Development data. It demonstrates that the regions received large numbers of proposals in the fall. The approvals were very slow during October and November 1985. The rate of approvals started to increase in December.

14.51 In 1985-86, Employment and Immigration Canada's total appropriation for employment and training programs was approximately $1.8 billion including Supplementary Estimates of $458 million approved in December 1985 for the Canadian Jobs Strategy. Of the total appropriation, $1.4 billion was expended resulting in a lapse of $357 million or 20 per cent of program funds. The lapse had two main causes: freezes by Treasury Board which amounted to approximately $228 million, and difficulties in the start up of the new Strategy, which accounted for about $129 million.

The Canadian Jobs Strategy in Operation

Continuing Strategy Adjustment

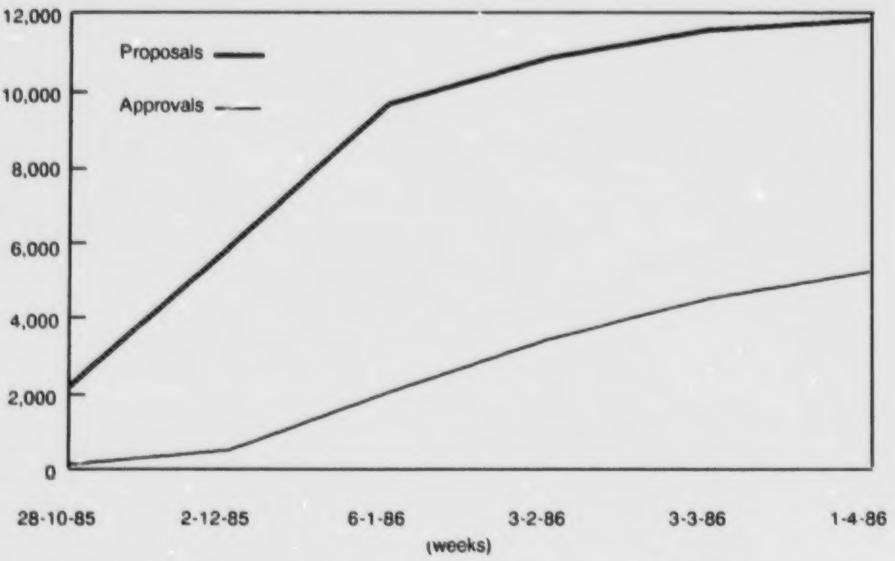
14.52 The concentration of effort prior to the program launch was on developing the concepts and designing and producing as many of the operational tools as possible in a short time. After implementation, adjustments to the strategy continued at the same time that initiatives were being undertaken to increase the effectiveness of program delivery.

14.53 In July 1986, a task force undertook a review of the Strategy's first year of operation to respond to both internal and external perceptions that the programs were complex and based on inconsistencies in mechanisms and work instruments. The review of the program delivery at the local level, as well as our audit work, identified a number of areas for improving the delivery of the Strategy.

14.54 There were difficulties in understanding the new programs. Many regional staff thought that the flexibility promised by the Strategy had fallen short. For example, they thought that the establishment of a single fixed date for Job Development, general projects proposals had limited the time available to develop quality projects. The many forms to meet program data requirements were creating a burden for users. In many areas of Employment and

Exhibit 14.5

CUMULATIVE PROPOSALS AND APPROVALS FOR JOB DEVELOPMENT PROJECTS ON A NATIONAL BASIS



Immigration Canada, there was great uncertainty over the anticipated organizational change. In addition, there was controversy over the best way to meet objectives of the programs.

14.55 The task force identified a number of alternatives for making improvements. Management decided to maintain the fundamental Strategy principles but alter the current design of programs and options to allow for the use of common mechanisms among options and for simplified payment and monitoring processes. Also the type of data to be gathered, forms, manuals, and processes were to be further simplified. Local delivery of most of the Strategy and a comprehensive internal communications and training program were to be implemented. The target for these changes was 1 April 1987.

14.56 Once the mandate was approved by senior management, the task force began the detailed work of examining areas for improvement and recommending specific changes in August 1986. A series of reports was tabled in the spring of 1987 with further recommendations for streamlining and simplifying the delivery of the Canadian Jobs Strategy. Implementation of the recommendations is expected to start 1 April 1988 with completion dates to be finalized for specific tasks.

14.57 Since summer 1985, Employment and Immigration Canada has been defining and implementing a new organization to facilitate effective management of the decentralized integrated program delivery. The reorganization will be completed in the three largest regions by 1989-90.

PROGRAM
REGI
PROGRAM
REGISTER
PROGRAM / OPTION

Manual accounting records for each of the Canadian Jobs Strategy programs are kept in many local offices (see paragraph 14.62).

14.58 By the beginning of fiscal year 1986-87, there were 31 program options. Five of the six programs had 15 separate objectives and 31 sub-objectives; terms and conditions varied with the program and the option. There were 18 different definitions of employers under the options. The delivery continued to be characterized by complex operational procedures and 140 different forms.

14.59 An analysis performed in March 1987 by supervisors of the local offices in one of the regions we audited pointed to continued problems with the use of forms. They reported for one of the Job Development options, Skill Investment and Skill Shortages, a lack of consistent communication of changes and directions for the completion of forms. They were also concerned about the complexity resulting from the large number of forms, duplication and inconsistent requirements coming from program and financial managers.

14.60 A senior committee on Canadian Jobs Strategy systems was established to identify management information systems problems and to determine corrective action. Several regions also took steps to address what they perceived as important regional requirements for timely and accurate data for managers and staff responsible for delivering programs.

14.61 The Canadian Jobs Strategy Systems Committee made a number of recommendations that resulted in interim measures that are being implemented such as using a common computer system in place of different systems for many of the programs. An internal group is examining further changes related to decentralizing automated support for program and financial information to meet local managers' operational and information needs. These initiatives are planned for implementation as of 1 April 1988.

14.62 Some regional managers have argued for an earlier implementation of a portion of the decentralized accounting system They believe that doing this would eliminate the current manual accounting records kept in many local offices, ease the paper flow to regional headquarters, and help to eliminate duplication. Above all, it would support the decentralization of the Canadian Jobs Strategy.

14.63 A phased approach that takes into account other Employment and Immigration priorities relating to Unemployment Insurance and National Employment Services is being used in implementing the decentralized Canadian Jobs Strategy systems. The earliest that Canadian Jobs Strategy management information could be accessed on line would be in 1988.

14.64 Employment and Immigration Canada believed that the implementation of the Strategy was always perceived to be an ongoing process that would permit modification to meet specific requirements. It argued that operational improvements such as systems, forms, organization and program design, could always be made.

Integration of Training in Institutions into the Canadian Jobs Strategy, 1986-87

14.65 In our 1986 Report, we reported on our audit of the National Institutional Training Program which was kept as a separate program in 1985-86. On 1 April 1986, training in institutions became an option under each of the Strategy programs except for the Innovations program. Because most of the federal-provincial agreements defining the principles for the purchase of training were made later than anticipated, we are only reporting on the overall planning for integrating institutional training into the Strategy.

14.66 The Canadian Jobs Strategy emphasizes developing the employability, through training on the job or in the classroom, of individual Canadians most in need of such help and in this way meeting labour market needs. In their objectives, the Job Development, Job Entry, Skill Shortages and Skill Investment programs explicitly refer to training participants.

14.67 Training in institutions is no longer identified as a separate program. All trainees must meet the eligibility criteria of one of the programs. A single training course can serve clients from more than one Strategy program. The principles that govern planning, purchasing and paying for training were to be defined in new training agreements to be effective on 1 April 1986. At that time only one federal-provincial agreement had been signed. Much of Employment and Immigration Canada's effort was directed to negotiating and getting agreements with the other nine provinces and two territories. Of the 12 agreements, one had not been signed by 1 July 1987.

14.68 An intent of the Strategy is to be flexible and responsive to local needs. There are, however, a number of constraints created by the federal-provincial training agreements. These relate to the level of available funding, future year's program commitments and joint federal-provincial planning.

14.69 The 1985-86 year was one of transition and adjustment in the implementation of the Canadian Jobs Strategy. There were difficulties associated with integrating training in institutions into the Strategy in 1986-87.

14.70 The Strategy provided a different approach to traditional training in institutions. This included a change in the eligibility criteria for trainees and new initiatives to increase responsiveness of training to labour market needs. Employment and Immigration Canada had indicated in the agreements its intention of increasing the real level of funding to be made available for training in institutions. Under the Strategy, more funds were to be provided indirectly to colleges through employers or through groups representing employers and workers (third parties). Less funding was to be provided direct to colleges through provincial and territorial governments. The reduction in direct purchases was designed to shift the responsibility for determining the kind and amount of relevant training to groups or individuals that were closer to employer needs. Employment and Immigration Canada expected that indirect purchases made by employers, sponsors and co-ordinators or third party groups would better reflect these needs.

14.71 Planning the shift to indirect purchases started as early as March 1985. There was a reference to a transition guarantee and a new method of purchasing training in the letter of intent signed with Ontario in November 1985. However, we found that at the beginning of the integration, regions had difficulty in interpreting Headquarters directions on how indirect purchases or commitments should be defined or monitored. The July 1986 task force reported a number of outstanding irritants regarding training being experienced at the local level. There were perceived contradictions between the stated intention to promote greater private sector involvement in training while increasing the commitment to the provinces through direct and indirect purchases. The terms and conditions for the new third party indirect purchases were not approved by Treasury Board until 9 October 1986.

14.72 Different arrangements have been made in the provinces and territories for indirect purchases. In addition to indirect purchases made by managing co-ordinators and contribution agreements sponsors, indirect purchases are also made through third party co-ordinating groups that make arrangements for training purchases. The co-ordinating group options were initially viewed as a mechanism for providing some stability in the transition from direct purchases to new arrangements, and it has become an increasingly important mechanism for indirect purchases. At the time of our audit, of the four regions we examined, Quebec and Ontario has signed agreements with co-ordinating groups. In Nova Scotia agreements were being finalized.

14.73 Since the new mechanisms for purchasing training in institutions were being put in place as the agreements were being signed, many of them were not in full operation at the time of our audit. Given the large portion of the Strategy funding spent on training in institutions, we will continue to monitor its implementation under the new agreements and, if necessary, report to Parliament.

Procedures for Measurement of Results

14.74 **Target groups.** At the Regina First Ministers' Conference, and in subsequent public pronouncements, a commitment was made to "equitable participation" in all programs of the new Canadian Jobs Strategy. A set of interim guidelines was established that described national targets for participation for four of the programs. Target groups were defined as including women, Native people, persons with disabilities and visible minorities.

14.75 The actual results compared with the targets were part of the overall reporting of program performance and were incorporated into Employment and Immigration Canada's planning and accountability process. Performance was to be monitored regularly at national headquarters and reported to the Minister. The initial guidelines called for additional consultation with the regions where there was a gap between the actual participation and the target level.

14.76 The 1985-86 figures were initially defined as interim targets. Regions have been complaining about what they saw as unrealistically high targets in some areas. Despite regional difficulties in attaining the targets and the general lack of an empirical basis for defining levels of labour force participation for some groups, the targets stayed essentially the same for 1986-87 and 1987-88.

14.77 In general, the targets established for participation by women and Native people were realistic and were achieved or surpassed in the Job Development, Job Entry and Skill Investment programs. Participation targets were not met as consistently in the case of disabled people and visible minorities. Targets were particularly difficult to achieve in the short-term for all groups in the Skill Shortages program, as shown in Exhibit 14.6, since this program was mainly designed for people already employed or taking apprenticeship training. These traditionally have low target group participation.

14.78 **Employment and Immigration Canada should establish more realistic short-term participation targets for the clientele covered by employment equity measures.**

> ***Employment and Immigration Canada's response:*** *EIC believes that its equity targets are ambitious and realistic. In some cases, achieving the targets may take several years.*
>
> *In recognition of this, EIC has recently adopted a dual target approach to be used beginning in fiscal year 1988-89, involving both long-term and operational targets. As in the past, long-term targets will be set. Regions will be required to identify their plans for achieving targets, including the kinds of special measures that will be used in cases where it is felt that targets would not otherwise be met. In addition, operational targets will be negotiated for each program such that*

Exhibit 14.6

TARGETED AND ACTUAL PARTICIPATION FOR CLIENT GROUPS COVERED BY EMPLOYMENT EQUITY MEASURES
1986-87
(percentage of participants)

	Women		Native People		Disabled People		Visible Minorities	
	Target	Actual	Target	Actual	Target	Actual	Target	Actual
Skill Shortages	20.0	8.5	5.0	2.0	6.0	0.1	3.0	0.5
Skill Investment	30.0	36.4	4.6	4.8	6.0	0.3	2.9	1.9
Job Development	35.0	46.3	9.6	12.4	4.0	4.5	4.7	4.0
Job Entry	-	-	-	-	6.0	1.3	-	-
- Entry	50.0	51.1	7.5	9.5	-	-	5.4	4.0
- Re-entry	100.0	99.7	8.1	7.3	-	-	5.3	4.5

where targets have not been achieved, a meaningful improvement in performance over the previous year will be required.

All numeric targets will be reviewed and refined in 1990-91 once data from the 1986 Census becomes available.

14.79 **Follow-up survey of participants.** Employment and Immigration Canada uses a survey of participants as the ongoing measure of Canadian Jobs Strategy effectiveness. This is done 3 and 12 months after participants have left a project or training course to find out whether an individual found a job and, if so, whether the training was relevant to the job found. The three-month follow-up survey, as designed, provides a sound mechanism for measuring the short-term results of the Canadian Jobs Strategy programs for participants. However, there have been some problems in implementation.

14.80 It takes time to get these survey results. The earliest that results could have been available was in December 1986. The first formal measurements of the success of the participants in the Canadian Jobs Strategy became available only in the spring of 1987, a year and a half into the program. For two options of Job Development that cost a forecast $352.2 million in 1986-87, there was limited indication of the program outcomes from the follow-up surveys of participants.

14.81 At the time of our audit, Employment and Immigration Canada had mailed survey forms to all participants that left the Canadian Jobs Strategy programs from April to September 1986. Measures were obtained for participants in Job Entry, Skill Investment, Skill Shortages and the Direct Purchase of Training options. But the results were incomplete for Job Development because participants that were sent questionnaires comprised only a small proportion of those scheduled to finish. For example, in the case of participants in Job

Development general projects, the option with the largest project expenditure, only 4.7 per cent of the participants scheduled to finish were surveyed.

14.82 Employment and Immigration Canada did not survey participants in Job Development general projects in Nova Scotia, New Brunswick, Manitoba, Saskatchewan and Alberta. Only 1.3 per cent were surveyed in Quebec. The required information on participants leaving early or completing Job Development programs had not been put into the management information system. Regions that entered the data and sponsors who filled in the forms had not been given adequate instructions on completing the forms and had not been advised of the importance of getting the data promptly into the management information system.

14.83 Program managers in Headquarters did not identify the problem until November 1986. Corrective action is still going on to ensure that information on participants is entered into the systems in time to be surveyed. Consequently, only limited measurement of results for participants in two Job Development options, general projects and projects for the severely employment disadvantaged, can be obtained by December 1987.

14.84 Initial results for the programs surveyed show that most participants were working or taking further training three months after they left a Canadian Jobs Strategy project or training – 67 per cent of those in Job Entry projects and 87 per cent for those in Skill Shortages projects. Program evaluations are planned to assess whether offering the program resulted in a net positive result for all six programs of the Canadian Jobs Strategy over the next four years. The first scheduled evaluation to be started this fiscal year is for Job Development.

14.85 Because of the incompleteness of client information and of the follow-up survey, the program evaluation for Job Development planned for 1987-88 will not be able to use the follow-up survey or the information that was to have been collected on participants. Employment and Immigration Canada has told us that its subsequent program evaluations will be built more on existing data bases and the follow-up surveys.

Information for Parliament

Vote Wording

14.86 Most Canadian Jobs Strategy programs are delivered through contribution agreements. Funds are voted through vote 15. Its wording, although consistent with the Employment and Immigration Reorganization Act of 1977, is not specific enough and does not reflect the activity of the Canadian Jobs Strategy programs. The stated purpose of the funding is "providing employment to unemployed workers and contributing to the betterment of the community". Five of the six programs do not have the objective of providing employment in terms of direct job creation; their objective is to increase the marketability and employability of individuals, expand employment opportunities, and meet the needs of the labour market. At least three of the six programs are not only for unemployed workers, as described in Exhibit 14.2. Although we understand the difficulties for Employment and Immigration Canada in changing vote wording, we believe that vote wording should reflect program activity.

14.87 **Employment and Immigration Canada, in consultation with the Treasury Board, should ensure that the vote wording reflects the activities of the programs that are being funded by the vote.**

> ***Employment and Immigration Canada's response:*** *EIC has reported to Parliament in the form and content of the Main Estimates as prescribed by Treasury Board. The matter of vote wording will be discussed further with Treasury Board.*

Reporting of a Major New Initiative

14.88 In 1987-88 Part III of the Estimates the narrative sections on the Canadian Jobs Strategy comprehensively describe the transition in labour market programming as the Strategy became operational while former programs were gradually being phased out. However, in reporting on the major new initiative, sufficient detail was not provided with respect to the number of participants and expenditures for 1985-86 on new programs although the information was available in Employment and Immigration Canada.

14.89 Former manpower and training programs reported program outputs in terms of work-weeks, jobs created and trainees started. The Canadian Jobs Strategy counts number of participants. The report on the number of Jobs Strategy participants does not distinguish between participants under the former programs and those under the new Canadian Jobs Strategy programs. For 1985-86 Part III of the Estimates reported 235,700 participants for former and new programs (excluding institutional training and section 38 of the Unemployment Insurance Act) of which 41,200 related to new programs.

14.90 Employment and Immigration's Part III showed only the total funds of $1.4 billion spent in 1985-86 for the new initiatives under Canadian Jobs Strategy and the former job creation programs combined. Therefore it is difficult to determine how much was spent on the newly announced program activities. Readers cannot determine, for example, that this amounted to $141.5 million.

14.91 **Employment and Immigration Canada should ensure that reporting of a major new initiative such as the Canadian Jobs Strategy in Part III of the Estimates specifically identifies the financial and participant data for that initiative.**

> ***Employment and Immigration Canada's response:*** *EIC is proud of the high quality of its information in Part III of the Main Estimates. The initial year of the Canadian Jobs Strategy, because it was a transition year in which former elements of labour market programming operated at the same time as new Canadian Jobs Strategy activities, presented a special challenge in how best to report to Parliament. The main difficulty was in presenting in a relatively uncomplicated way, data which was associated with elements of both former and new programs. Given these complexities, EIC decided that the most appropriate format would display total funds made available and spent in 1985-86 for Canadian Jobs Strategy and the former job creation programs, combined.*

Financial Management and Control

14.92 Financial management involves making decisions with full knowledge of their financial implications, ensuring that money is spent with due regard for economy, efficiency and effectiveness and ensuring that complete information is available so that managers can be held accountable for their actions.

14.93 Financial control involves the safeguarding of assets, ensuring the accuracy and reliability of accounting data, ensuring that money is spent for the purposes intended, and ensuring that spending does not exceed the levels approved by Parliament.

14.94 Sound financial management and control depend on effective integration of financial and operational information, as well as on the efficient use of this information. At Employment and Immigration Canada, most of this information is assembled in the Employment and Immigration Information System.

14.95 The information is gathered through various components of Employment and Immigration Canada's planning and accountability process. This process describes and documents the activities and responsibilities for strategic and operational planning, monitoring, reporting, audit and evaluation. The components of Employment and Immigration Canada's planning and accountability process are well integrated with overall government planning and accountability. They are the basis for the ongoing operations within Employment and Immigration Canada.

Information for Resource Allocation and Operations

14.96 The Operational Plan Framework establishes the context within which the Multi-year Operational Plan and individual operational plans are prepared, resources allocated and accountability reported. These three documents (the first two are submitted to Treasury Board) should set out objectives, expected results, and performance indicators for programs and activities in precise and measurable terms and should establish the linkages between them.

14.97 One of the purposes of the Operational Plan Framework is to establish clear objectives for the department, the results it expects to achieve, and the indicators it will use to measure efficiency and effectiveness for purposes of accounting for the use of the funds allocated to it.

14.98 The Operational Plan Framework of Employment and Immigration Canada sets out five operational planning levels within the organization: mandate, programs, activities, sub-activities, and sub-sub-activities, also referred to as options. The Multi-year Operational Plan uses these same five levels. The individual operational plans refer to them.

14.99 Our audit covered the August 1985 Operational Plan Framework and the September 1986 changes to it, with particular reference to the Employment and Insurance program. We also examined the links between the Operational Plan Framework and the subsequent planning steps in the Multi-year Operational Plans and the operational plans with respect to resource allocation.

14.100 We believe that the Operational Plan Framework is a good reflection of the organizational structure of Employment and Immigration Canada, as well as the operations of its various programs and responsibility centres.

14.101 In the Operational Plan Framework, the part of the mandate relating to employment describes Employment and Immigration Canada's mission as developing and implementing policies and programs to facilitate the smooth functioning of the Canadian labour market, consistent with the country's economic and social goals.

14.102 For the Employment and Insurance program, the objective is stated in the same words as those used in the mission statement. This objective is too broad. It is not sufficiently precise to serve as a basis for allocating resources, measuring performance, or ensuring accountability, given the limited role of Employment and Immigration Canada within the overall economy. Although Employment and Immigration Canada agrees with this assessment, it believes that the objective, at this level, must be stated in general terms because of the great diversity in the substance and elements of this program.

14.103 We reviewed the Human Resource Development activity (including the Canadian Jobs Strategy) and its sub-activities. Although the objectives in themselves are not sufficiently complete or precise for resource allocation and accountability purposes (for example, the notion of increasing employability), Employment and Immigration Canada has, however, established links between the objectives and the expected results, in the form of performance indicators. For the Human Resource Development activity, Employment and Immigration Canada has just completed the first phase of the analysis of data to measure results.

14.104 The objectives of the five sub-activities of the Unemployment Insurance program are stated in more precise and measurable terms. Even so, neither the expected results nor the performance indicators for the five sub-activities are linked back to that portion of the program objective which is to facilitate growth and adjustment in the economy. Treasury Board expressed the same concern with respect to the Unemployment Insurance activity in July 1985.

14.105 Although we believe some improvements are necessary in certain parts of the Operational Plan Framework, our analysis showed that Employment and Immigration Canada has made worthwhile and constructive efforts to develop a useful document. Treasury Board has already observed on the need for certain improvements, as well as the overall quality of the document.

14.106 In January 1987, Treasury Board approved Employment and Immigration Canada's Operational Plan Framework, despite reservations about the performance indicators established for the National Employment Service. However, the Operational Plan Framework will have to be reviewed in light of Increased Ministerial Authority and Accountability (IMAA).

14.107 In its Multi-year Operational Plan submission to Treasury Board, Employment and Immigration Canada did not quantify the program results it expected to achieve, making it difficult to discern the links between results and resource requirements. We also noted that the sub-sub-activities of the Human Resource Development activity are described in greater detail in the Multi-year Operational Plan than in the Operational Plan Framework. However, the statements of objectives of these sub-sub-activities are incomplete and not sufficiently precise.

14.108 Resources are allocated to existing programs as well as to new programs or initiatives. As part of the new initiatives in the Canadian Jobs Strategy, funding allocations were to "ensure that the total amount of job creation and training funds in a region is equitable and in line with the employment and training requirements in that region." Unlike past programs, Canadian Jobs Strategy program funds were approved in a single block. The initial allocation among Strategy programs had been made at the First Ministers' Conference in February 1985. Employment and Immigration Canada subsequently made the allocation by region.

14.109 The allocation in 1985-86 formed the base for the allocation to the regions in 1986-87 and 1987-88, with some adjustments made at Headquarters from the national reserve. The main consideration in the regional allocation in 1985-86 was stability in the funding levels compared to the allocations for job creation and training programs in 1984-85. As we were informed by Employment and Immigration Canada, if the allocation had been based on the proportion of long-term unemployed in each region, five regions would have received proportionally less than their 1984-85 allocation; three would have received more. Budget allocation to the regions was based more on stability in funding levels and on historical levels of funding than on responding to client needs.

14.110 Once Canadian Jobs Strategy program funds are approved, Employment and Immigration Canada determines an operational indicator – the number of participants.

14.111 Funds allotted to delivering the Canadian Jobs Strategy are budgeted according to program funds, recent experience with unit costs, and decisions made by management. Person-years are allocated on the basis of each program's relative share of funding in the previous year. Because of the flexible and decentralized funding arrangements, budget adjustments based on analysis take place as the year proceeds.

14.112 With respect to existing programs, our audit covered budgeting for 1986-87. We noted that in preparing operational plans, managers defined their priorities and set operational targets. These related to efficiency (the number of claims processed per person-year, in the case of Unemployment Insurance) and level of service (the number of Unemployment Insurance claims processed within 21 days).

14.113 For example, in processing Unemployment Insurance claims, Employment and Immigration Canada uses established efficiency targets, where suitable, to determine the required number of person-years. These efficiency targets are developed on the basis of historical data and planning directives issued in the Chairman's Planning Guidelines; they are challenged by the finance group and negotiated with each region at the executive director level.

14.114 Targets established during the planning process serve as performance indicators. Each month, local offices, district offices, the regions, and Headquarters prepare reports on actual results compared with budgets and established targets. Quarterly analyses of variances between budgets, targets and results are prepared at all management levels, discussed and challenged by the National Executive Committee.

14.115 In the case of the Unemployment Insurance activity, variance analyses are based on performance indicators showing the relationship between outputs and the use of resources; that is, the number of claims processed per person-year. With respect to the Canadian Jobs Strategy, analyses of financial results and of operational results are not integrated in reports to the National Executive Committee. Although both analyses are presented in the report to the Committee, managers have not developed a means of comparing operational results with the amount of funds used. For example, there is no indicator of program costs in relation to volume of participants. However, as we observed with respect to the redistribution of funds within the Canadian Jobs Strategy, Employment and Immigration Canada attempts to compensate for this shortcoming with periodic analyses that have served as the basis for management decisions.

Information to Ensure Accountability for Financial Management

14.116 Accountability includes the requirement that managers account to their superiors for their performance and that departments report to Parliament.

14.117 In Employment and Immigration Canada, management accountability is provided through management contracts between managers and their superiors. The contracts are developed at the same time as operational plans are being established. They include objectives and deadlines for accomplishing them as well as the goals and targets set out in the plans. Each quarter, results are assessed in relation to objectives, and goals are adjusted when operational plans change.

14.118 Accountability to Parliament is provided in part through Part III of the Estimates. Our observations about the Employment and Immigration Canada's Part III were set out earlier in this chapter.

Financial Control

14.119 Follow-up to the 1974-76 Financial Management and Control Study, our audits of systems conducted in 1984-85 and earlier, and follow-up of our observations of the past three years have not disclosed any significant shortcomings in the internal financial control system. However, in our opinion on the financial statements of the Unemployment Insurance

Account for the year ended 31 December 1985, we expressed reservation on the validity of the amount overcharged to the government share of expenditures on claims in 1985. There is an audit note to this effect in Chapter 3.

Financial Information Systems

14.120 The Employment and Immigration Information System is an integrated management information system incorporating financial, operational and personnel data. The information produced by the system is used by managers to monitor and report on their operations. In general, managers are satisfied that the information produced is accurate and reliable.

14.121 Despite this, our audit showed that the system does not meet all the requirements of managers with respect to timeliness, particularly those in district and local offices. Employment and Immigration Canada recently set up pilot projects to correct these shortcomings.

14.122 The information system gathers a great deal of financial information that is also collected by the Department of Supply and Services (DSS). Negotiations between Employment and Immigration Canada and DSS were started in 1981, with the aim of eliminating this duplication of effort. But the departments have not yet reached agreement. We think that such an agreement could result in a net saving of 10 person-years.

The Role of the Financial Function

14.123 Financial officers play an important role in making line managers aware of all the financial aspects of management.

14.124 The Executive Director, Finance and Administration, has a significant mandate relating to financial management within Employment and Immigration Canada. He plays an active role on the National Executive Committee and other committees and contributes to their decisions. In particular, the Executive Director is responsible for the Employment and Immigration Information System; the Director General, Financial Services, co-chairs the performance measurement committee.

14.125 Since 1975, significant progress has been achieved in financial administration structure and processes. At the time of the integration of the Department of Manpower and Immigration and the Unemployment Insurance Commission, steps were taken to improve financial administration, to establish an internal control section, a planning and accountability process and an integrated management information system.

14.126 Financial Services also has a significant role in preparing and challenging operational plans.

14.127 The Financial Services organization in Employment and Immigration Canada examines all Treasury Board submissions for format and contents, as well as other documents with financial implications. Financial Services is also responsible with the Strategic Policy and Planning Group for the functioning of the planning and accountability process. Despite the active role played by financial officers, there were shortcomings with respect to financial analysis in developing major new initiatives. These are mentioned earlier in this chapter.

14.128 In collaboration with the Strategic Policy and Planning Group, Financial Services conducts quarterly analyses of operational and financial results. These are sent to the National Executive Committee.

SPECIAL AUDITS

SPECIAL AUDITS

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15

SPECIAL AUDITS

Introduction

15.1 Much of the Audit Office's work concentrates on comprehensive audits of departments or on government-wide audits. Over the past several years, however, the Office has begun to conduct "special" audits of specific programs or activities that would not be addressed by comprehensive or government-wide examinations.

15.2 The responsibility for these special audits has been consolidated and provision was made for the results of the work to be reported in one chapter.

15.3 The Special Audits group examines specific programs or activities within a department or across several departments. Normally, the audits address matters that would not be audited on a regular basis, but that are important nonetheless. This approach increases the efficiency and effectiveness of the Audit Office and at the same time allows the results of work to be reported to Parliament as quickly as possible.

15.4 This year's chapter contains reports on Fraud Reporting, Risk Management, Major Capital Projects, Emergency Preparedness, and Microcomputers.

FRAUD REPORTING

Reporting of Fraud and Other Illegal Activity Against the Government of Canada

15.5 In 1983, Parliament amended the Financial Administration Act (FAA) with respect to losses of money and public property. The passage of section 91.1 empowers the Governor in Council, on the recommendation of Treasury Board, to make regulations prescribing the actions to be taken "in respect of losses of money or public property, however caused, suffered by Her Majesty." This amendment replaced a section that addressed only losses resulting from fraud by public officers.

15.6 Section 92 of the FAA was also amended to require every person connected with the collection, management or disbursement of public money who has knowledge of a violation of the FAA, associated regulations or any revenue law or of fraud against Her Majesty to report it in writing to any superior officer. The penalty on conviction for failure to report is a fine not exceeding $5,000 and imprisonment for up to five years.

15.7 In 1984 the Office of the Auditor General initiated a review of the government's procedures to report instances of fraud and other illegal activities against the Crown. In 1985 we advised the President of Treasury Board that:

- procedures were inadequate to ensure that Treasury Board, the RCMP, the Deputy Attorney General and Parliament received reliable reports of instances of illegal activity against the Crown;
- procedures were inadequate to ensure that ministers and deputy heads received reliable reports on suspected unlawful activity and that such instances were being investigated in an independent, co-ordinated and timely manner;
- most departments did not have a centre responsible for receiving reports of suspected illegal activity and co-ordinating subsequent action and reporting; and
- employees had not been informed of their increased responsibilities to report fraud and violations of the FAA and associated regulations under the revised FAA.

15.8 We recommended that:

- the Treasury Board take action to establish uniform procedures to ensure that frauds and other illegal activity against Her Majesty in departments and Crown corporations are independently investigated and reported to the minister, the deputy minister, the RCMP and the Deputy Attorney General and Parliament;
- agencies designate a co-ordinating unit to receive reports of suspected cases and ensure that they are investigated and reported in an independent and timely manner; and

- deputy ministers advise their employees in writing about their responsibilities under section 92 of the FAA.

15.9 The President of Treasury Board advised us that these matters would be addressed within two years.

Governor in Council and Treasury Board Action

15.10 Although the amendments to the FAA were passed in 1983, the Governor in Council has not yet established regulations regarding losses of money and public property. However, on 20 February 1987 the Treasury Board issued Circular Number 1987-6, entitled "Losses of Money suffered by Her Majesty and Offences and Other Illegal Acts Against the Crown". The Circular covers all losses of money, including those resulting from illegal activity. It applies to departments, agencies and departmental corporations. It does not cover losses of public property and does not apply to Crown corporations.

15.11 The Circular requires that losses of money because of fraud or illegal activity be reported to the RCMP, the Assistant Deputy Attorney General and to Parliament in the Public Accounts. It advises deputy heads that the RCMP, not departmental officials, has primary responsibility for investigating offences against the Crown.

15.12 It also advises deputy heads that agencies should establish measures to reduce the opportunity for fraud and other illegal activity. The measures expected are outlined in Annex A of the Circular. They include the designation of an existing independent function, reporting to the deputy head, to receive all reports and ensure that an independent investigation is conducted. There is also a requirement to inform employees of their responsibilities under the Criminal Code and the FAA.

15.13 The policies and procedures outlined in the Treasury Board Circular address most of the matters we raised with the President of Treasury Board regarding losses of money resulting from illegal activity in departments and agencies. We plan to conduct an audit of the adequacy of the implementation of the procedures in 1987-88.

Crown Corporations

15.14 The Crown Corporations Directorate, Department of Finance and Treasury Board, has advised us that it will propose that the President of the Treasury Board write to ministers responsible for Crown corporations requesting that they ask the corporation to ensure that (a) reporting systems are in place that would allow losses of money and property of any material size to be brought quickly to the attention of corporate management and (b) frauds and other illegal activity are independently investigated by the RCMP.

15.15 We recommend that material losses in Crown corporations due to fraud and illegal activity be consolidated and reported to Parliament. The Crown Corporation Directorate has suggested that sufficient avenues exist for material losses of Crown corporations to be brought to light through the mechanisms of annual audits and special examinations and through specific requests by parliamentary committees. We believe it would be more desirable for information to be made available to Parliament in an annual consolidated report by the Treasury Board, for example, the President of Treasury Board's annual report on Crown corporations.

Losses of Public Property

15.16 Treasury Board Secretariat (Administration Policy Branch) has not yet issued specific directives to advise departments that damages, including losses of public property due to fraud or other illegal acts, are subject to the provisions of existing directives and policies on security of materiel and claims regulations. The Secretariat has advised that it plans to issue these policies and directives by November 1987 and that the directives will include requirements for reporting to Parliament.

RISK MANAGEMENT AUDITS

15.17 In 1986 we strengthened our risk management audit procedures. The procedures are designed to assess the adequacy of the measures taken by departments and agencies to minimize the risk of losses to the Crown.

15.18 We focused our attention in this area on selected major capital projects. During 1986-87 we conducted risk management audits of three of the capital projects discussed in the Major Capital Projects section of this chapter. These include the Types 1050 and 1100 Navaids Tender/Light Icebreaker, buildings for the National Research Council Institutes in St. John's, Newfoundland, and Winnipeg, Manitoba, and the Canada Olympic Park in Alberta.

15.19 We found deficiencies in procedures to reduce the risk of loss. We have referred the matters to the responsible departments for any further examination and corrective action.

Navaids Tender/Light Icebreaker

15.20 As indicated in the Major Capital Projects section of this chapter, the Department of Supply and Services authorized payments to a contractor over $19 million in payments for one of the six Navaids Tender/Light Icebreakers. The contractor went into receivership 14 months after the contract was signed.

15.21 The receiver for the company reported that the actual amount spent on building the ship was $8,808,072. His report stated that the "balance of the funding of $10,320,615 appears to have funded other costs within the company." We also could not determine exactly where the funds had been spent.

15.22 The Department of Supply and Services (DSS) did not prevent or detect this apparent use of funds for purposes not specified in the contract.

> **Department's response**: *DSS states that, consistent with the objectives of the Special Recovery Capital Projects Program, payments under this contract included a profit element and were based on the contractor's achievement of certain "milestones" described in the contract. Thus, unlike cost-reimbursable contracts, where payments are based on the actual cost of work done, in this case, there was nothing to compel the contractor to apply moneys received, at any particular instant in time, solely to this specific contract. As it achieved each milestone described in the contract, it became entitled to the payment corresponding to that milestone.*
>
> *The situation which apparently resulted in the above-noted case was specifically rectified in the renegotiated contract for the completion of the Type 1100, in that "milestones" were deleted from the contract, and "progress payments based on the assessed percentage completion of the actual physical progress of the work" were used instead. The contract was successfully completed using this approach.*

Department of Supply and Services

15.23 We have been informed by the Department of Supply and Services that it does not normally verify information about education and experience in contracts where the qualifications of individuals are an important factor.

15.24 It is DSS's policy to investigate a firm or individual if it believes there is cause to do so. The Department, in the absence of cause, states that it relies on the judgement and experience of contracting officers.

15.25 We believe a more systematic verification procedure may be required. We suggest that DSS review its procedures and consider developing a sampling-based verification program to provide the necessary assurances and act as a deterrent to the provision of false or misleading information.

> ***Department's response**: The Department agrees to review its procedures, but is concerned that the proposed sampling approach would prove objectionable to suppliers and would not produce value for money. As an alternative, we would introduce a standard clause in contracts for the services of individuals which would require proposers to certify the accuracy of their statements with provision for verification as necessary.*

MAJOR CAPITAL PROJECTS

Overview

15.26 We reviewed 12 projects this year, in addition to those examined during comprehensive audits, as part of our continuing examination of the federal government's capital expenditures. Total expenditures on these projects are estimated to be about $1.6 billion. We selected them because they are representative of the capital expenditure profile of various government departments. Five projects are reported in Chapter 9 dealing with the Department of National Defence, one in Chapter 8 concerning the Department of External Affairs and four in this chapter. In two other cases, we reported direct to departments because the matters weren't so significant that they needed to be brought to the attention of the House.

Audit Scope

15.27 We examined each project using methodology and criteria developed by the Office of the Auditor General and agreed to by the departments concerned. Emphasis was placed on the planning and implementation processes in place in departments and on the interrelationship between the specific project and the overall departmental objectives.

15.28 We placed particular emphasis on the contracting phase of implementation. This was done to determine whether the service agencies (Department of Supply and Services and Department of Public Works) had followed existing regulations and had given due regard to economy in their phases of project development.

15.29 We also examined the commissioning phase – the time when services or goods are delivered – to ensure that departments actually received the equipment or building as contracted.

Observations

Planning

15.30 In our 1986 Report we commented on the length of planning time involved in acquiring capital assets. The situation is still the same, except for 2 of the 12 projects. The Type 1100 ships and one of the National Research Council laboratories were constructed under the Special Recovery Capital Projects Program. This significantly reduced the length of the planning phase. We found that specific life cycle costing was not completed for the Type 1100 ships and the Lake Louise project. All these projects are described later in the case studies.

Needs Definition

15.31 The need for a specific capital asset was, in one case, not well defined. The National Research Council's Institute for Marine Dynamics was built, but no clear need for a new institute in St. John's had been established at the time of submission.

Contracting

15.32 In the case of the Type 1100 ships, we found that the Department of Supply and Services did not oversee the construction contract for one ship in an effective manner. In the Lake Louise redevelopment case, the Department of the Environment allowed private sector construction to proceed prior to agreements with the Crown being finalized.

Case Study 1. The Type 1050 and Type 1100 Navaids Tender/Light Icebreaker

15.33 In July 1983, Treasury Board approved $487.88 million under the Special Recovery Capital Projects Program for the Canadian Coast Guard to construct two Type 1050 and six Type 1100 Navaids Tender/Light Icebreakers. The approval included the cost of completing a mid-life modernization of the ship, *Sir Humphrey Gilbert*.

15.34 **Background.** In 1979 the government approved the Canadian Coast Guard Fleet Capital Investment Plan Segment I. It gave preliminary project approval to construct four Type 1100 ships. The Plan was updated in 1982 to include a total of 25 fleet units, 13 of which were to be Type 1100. Twelve were to be Type 1000 (2 of the 12 were designated Type 1050). In April 1983, the government announced the Special Recovery Capital Projects Program, and the Department of Transport proposed a project for vessel acquisition and modernization in accordance with the Fleet Capital Investment Plan. The Department received effective project approval to construct six Type 1100 and two Type 1050 ships and to refit the *Sir Humphrey Gilbert*. The remaining ships are to be constructed in accordance with the Fleet Capital Investment Plan Schedule.

15.35 **Audit scope.** We concentrated on the planning, acquisition and implementation phases for the Type 1050 and Type 1100 ships. We reviewed only those aspects of the Fleet Capital Investment Plan related to the statement of requirement for these ships.

15.36 **Needs definition.** The definition of need, requirements and options analysis for the Type 1050 and 1100 vessels is contained in the Plan. This analysis points out that "the core fleet capability for basic aids to navigation support and light icebreaking is provided by vessels in the Type 1000/1100 category".

15.37 We found that in identifying the need for these vessels, the Department stated that the objective of the Fleet Capital Investment Plan is to ensure that the necessary Coast Guard operational mission capability is maintained. At present, Canadian Coast Guard fleet capital investment focuses on replacing vessels to provide core level support. According to the Plan, "levels of service do not have a major impact on Fleet Capital Investment Plan priorities at this stage". In our view, levels of service are an integral part of the planning process to ensure that the fleet size is adequate for the operational mission.

15.38 We did not find evidence that specific life cycle costing had been prepared for these vessels. We are concerned that the failure to establish specific life cycle costs could result in the Department of Transport acquiring vessels that are unnecessarily costly to construct, operate and maintain.

15.39 **Contracting.** Contracting for the two Type 1050 vessels was relatively straightforward. The Coast Guard sent the specifications and requisitions to the Department of Supply and Services (DSS). DSS identified 16 shipyards to whom Requests for Proposal were sent. Because of regional considerations, it was decided to select one yard on the east coast and one on the west coast. The lowest qualifying bid from each coast was selected and the contracts were negotiated.

15.40 For the Type 1100 vessels, the process was more complex. Initially the Requests for Proposal for two ships were sent to seven shipyards. Seven bids were received by the bid closing date. A joint Coast Guard/Supply and Services evaluation team was formed. It was prepared to recommend awarding the contract shortly after the bids were received.

15.41 On 19 April 1983 the government announced the Special Recovery Capital Projects Program. The Department of Transport responded by increasing the requirement for vessels to six, all to be constructed within a three-year period. The original seven yards were instructed to amend their proposals to include the construction of one or two vessels. An evaluation committee was able to clarify all bids except one, from a yard that had not provided adequate information. In addition this yard was deemed non-responsive and unqualified because it had not built a ship of the Type 1100 size for 15 years and had a less than satisfactory on time/within budget performance.

15.42 Contracts for five of the six ships were awarded as follows:

Quebec	2 ships
British Columbia	2 ships
Ontario	1 ship

15.43 The contract for the sixth ship was awarded to the Nova Scotia yard that had initially been deemed non-responsive. Following a management change in the yard, arrangements for technical support from other qualified firms, and a provincial guarantee of 20 per cent of the value of the contract, DSS recommended that the yard be assessed as qualified and responsive. The contract for $54.9 million to build one Type 1100 vessel was awarded in October 1983, with delivery scheduled for May 1986. The yard was placed in receivership by the Province of Nova Scotia in December 1984 and in bankruptcy in June 1985 after $19.2 million had been paid to the company for construction of the ship. The contract to complete the ship was renegotiated with the bankruptcy trustee in July 1985, at a cost of $44.4 million, raising the cost of the vessel to $63.6 million.

15.44 The decision was made to award the contract to a shipyard initially assessed as non-responsive, and later assessed by DSS as qualified and responsive, even though the contractor's past performance demonstrated there was a higher risk of its being unable to perform. This placed the government at greater risk than normal. In our view this removed the protection normally afforded the Crown throughout the bidding process.

15.45 **Contract monitoring.** The contracts for the six Type 1100 vessels were designed to provide a degree of 'self-financing'. The amount paid to each contractor was based on milestones tied to the contractor's projected cash flow rather than the master work schedule. This resulted in a saving to the government on the contract price of approximately $1.5 million for each Type 1100 ship.

15.46 With the use of these milestones, payments in excess of work completed of $2 million to $3 million were expected based on projected cash flow. However, the milestones did not specify the level of parallel or ancilliary work such as piping and outfitting required to meet a milestone.

15.47 When a specific milestone had been reached, the contractor submitted a statutory declaration and a claim for payment. The statutory declaration stated "that no accounts payable are overdue to suppliers or sub-contractors" and "that all wages have been paid". The claim form, certified by the contractor, stated that "the claim is consistent with progress of the work and conforms to the terms of the contract" and that "no liens or claims exist against the work".

15.48 The claim form was certified by the DSS Inspection Authority and the DSS contract manager. It was then sent to the Coast Guard for certification by the project manager as to work performed and for certification pursuant to section 27 of the Financial Administration Act.

15.49 For five of the six ships, these procedures were adequate. But in the case of the ship contracted to the bidder initially deemed non-responsive, this was not the case.

15.50 At the outset, the Department of Supply and Services and the Coast Guard were clearly aware of the shipyard's technical and management shortcomings. The Coast Guard had advised DSS of its concerns in this matter. When we reviewed the DSS and Coast Guard files related to this contract, we noted problems with respect to certifications. The contractor had certified that accounts payable relating to progress claims were not overdue at the time of the claims. But at the time the yard went into receivership, 14 months after the contract was signed, accounts payable to suppliers and sub-contractors totalled $2.6 million as of the date of receivership.

15.51 DSS certified the quality and progress of work. But we noted instances where only steel work had been completed; ancillary work such as piping and outfitting had not kept pace. By the time the yard went into receivership, milestone payments totalled $19,128,687. The receiver reported that "actual payments made, assuming all overheads as applied to the 1100 Navaids contract have been paid, amount to $8,808,072". His report also states that "the balance of the funding of $10,320,615 appears to have funded other costs within the company".

15.52 Despite the fact that the Department of Supply and Services had noted problems with respect to ancillary work keeping pace with milestone payments, they did not take appropriate steps to determine what costs were being funded by the milestone payments.

Consequently, the shipyard was apparently able to divert \$10.3 million to costs other than the Type 1100.

15.53 There were other problems in the construction of this vessel. Early in construction, the vessel's keel sagged 1-1 2 inches on the building berth when the main propulsion machinery was installed. This caused several decks and bulkheads to buckle. The breadth of the vessel was also reduced slightly. As a result, the Coast Guard required that Lloyds of London and Coast Guard Ship Safety give assurance that the ship was certifiable.

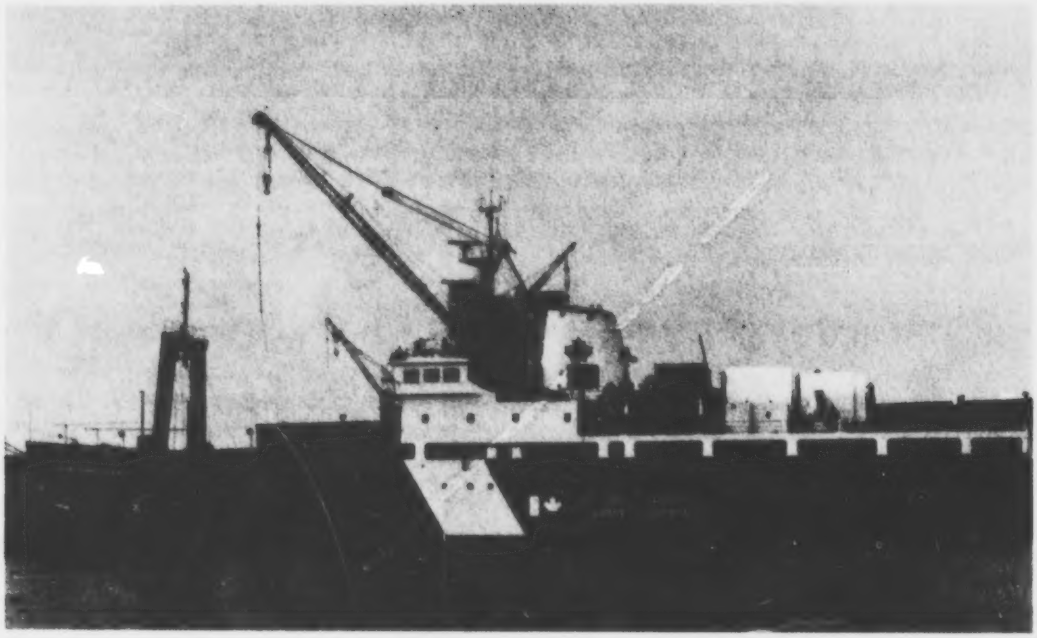
15.54 Because of the deformation, the vessel was outside dimensional tolerances, and the DSS Inspection Authority refused to certify the progress payments. Five progress payments totalling \$6.1 million were made between March 1986 and June 1986, without certification by the Inspection Authority that the quality of work was in accordance with the standards of the contract, although \$342,565 was retained as a holdback. The ship was ultimately accepted by Lloyds and by Ship Safety.

15.55 **Contract renegotiations.** Because of the yard's receivership and bankruptcy, DSS had to renegotiate the contract for the type 1100 as well as the contracts for the modernization of two other ships, with the receiver. The receiver indicated that the shipyard had a funding deficiency of \$28.6 million on all these government contracts to be divided between federal and provincial governments (the guarantors). One of the amounts included in the deficiency figure of \$28.6 million was \$10.1 million for accounts payable. The additional amount required from the federal government to pay the total debt was \$10.7 million. The Coast Guard agreed to fund \$5.6 million of this deficiency, subject to all accounts payable being settled in full. Funding for the remaining \$5.1 million was requested from the Cabinet Committee on Economic and Regional Development.

15.56 In June 1985, Treasury Board gave approval in principle to renegotiate contracts with the receiver for refitting two ships and completing the Type 1100 vessel, subject to conditions that included settlement of suppliers' and sub-contractors' accounts.

15.57 Once the new contracts had been finalized, the Coast Guard indicated its concern that the suppliers' accounts were being settled at less than 100 per cent; thus the Coast Guard argued the conditions had not been fulfilled. DSS responded that emphasis had been placed initially on settling trade accounts in full, but in the latter stages of negotiation the understanding was reached that the receiver would settle accounts to the extent necessary to obtain releases. Thus, although \$10.1 million for suppliers' and sub-contractors' accounts had been included in calculating the shortfall and the proportionate share to be borne by the Federal and Provincial governments, the settlement of these accounts by the receiver appointed by the Province has not resulted in suppliers and sub-contractors being paid in full.

15.58 **Commissioning.** At the time of our audit the Type 1050 vessels and four of the six Type 1100 ships had been delivered. Both 1050s are operating with only minor problems. The first two 1100s delivered are operating on the west coast. Although both ships had propulsion system control problems, these difficulties have been partially corrected.



The Type 1100 Navaids Tender Light Icebreaker during final fit out. The buoy handling equipment has not been installed (see paragraph 15.59).

15.59 But a more serious problem was encountered with the buoy handling system for the six Type 1100 ships. This equipment was specified by the Coast Guard in accordance with the requirement of the Department of Regional Industrial Expansion to maximize Canadian content in the ships. A Canadian firm was specified as the supplier, with a number of Canadian and foreign companies involved. The buoy handling equipment does not meet specifications and has required extensive modification.

Case Study 2. National Research Council Institutes

15.60 The National Research Council has built an Institute for Marine Dynamics in St. John's, Newfoundland, at an estimated cost of $55.6 million including equipment, and a Canadian Institute for Industrial Technology in Winnipeg, Manitoba, at an estimated cost of $42.6 million including equipment. Neither Institute is complete; both require additional equipment to meet the objectives for which they were designed. To date, $82 million has been spent on the two projects. The Winnipeg facility was constructed under the Special Recovery Capital Projects Program.

15.61 The National Research Council was directed by the government to locate the institutions in St. John's and in Winnipeg. As a result of this, costs of at least $32.5 million were incurred that were unrelated to the Council's initial objectives. It cost a further $225,000 to accelerate the construction schedules for the building in Winnipeg in an attempt to meet the time objectives of the Special Recovery Capital Projects Program. In addition, the National Research Council continues to incur operating costs of approximately $1 million annually to maintain what was, at the time of our audit, an empty building in Winnipeg. It was empty because of a government decision to cancel the program for which the building was built. With the exception of a segmented wave-making capability, the St. John's facility is functioning.

Institute for Marine Dynamics (St. John's)

15.62 **Needs definition/options analysis.** In response to the federal government's Oceans Policy, announced in 1973, the National Research Council (NRC) got approval from Treasury Board in 1977 to build an ice tank laboratory in Ottawa at an estimated cost of $5.57 million. Following a request from Memorial University of Newfoundland that NRC consider building the institute on the University campus, the Council was directed by the government to build an "integrated centre of excellence in Marine and Ice Dynamics" in St. John's. The centre was approved by Treasury Board at a final cost of $55.6 million.

15.63 The National Research Council finished defining the technical requirements of the integrated centre after Treasury Board had initially approved the project. Also after initial Treasury Board approval, the Council commissioned a consultant's study on the potential use of the new facility. The consultant's report urged caution and was pessimistic about potential commercial returns. The consultant indicated that the Council could expect an increase in annual revenues of only $60,000 from the project. The Council did not consider this information of sufficient import to require changing the project plan. Nor was it referred to Treasury Board for its consideration.

15.64 In our view, with which NRC agrees, the Council could have met the objectives of the Oceans Policy and saved $30 million by increasing its marine dynamics capability in Ottawa.

15.65 **Program management.** We examined the management of the project and concluded that, once construction of the facility started, the National Research Council, the Department of Public Works and the Department of Supply and Services managed the project well. With the exception of a segmented wavemaker, a major item of equipment expected to cost between $10 million and $12 million, the project is complete, and it is within the costs approved by Treasury Board.

15.66 **Present situation.** The building and facilities are essentially complete and in operation, but at the time of our audit they had attracted few clients. In implementing this project, NRC assumed a sizeable risk in terms of whether the new facilities would address technical requirements that were in fact growing and that would be relevant to the needs of Canadian clients. This risk was considerably greater than it would have been had NRC been authorized to proceed with its initial proposal. The facilities will not have an advanced stability testing capability until the segmented wavemaker is installed.

Canadian Institute for Industrial Technology (Winnipeg)

15.67 An objective of the Special Recovery Capital Projects Program (SRCPP) was to accelerate "over the next four years a number of capital projects selected for their potentially important contributions to Canada's economic and regional development requirements." Put simply, the major criteria, as published by the Deputy Minister of Public Works, were "shovels in the ground by October 1983, and 60 per cent of funds spent by 31 March 1985." In the absence, initially, of more precise criteria against which to evaluate proposals, the risks were high that projects would be included that had a low likelihood of meeting SRCPP's objectives or those of the programs that the projects were designed to support.

15.68 In response to a request from the government of Manitoba in 1980, the National Research Council proposed to build a national institute to conduct applied research in manufacturing science and production technology. In 1983, the proposed institute was included under the Special Recovery Capital Projects Program at an approved cost of $42.6 million.

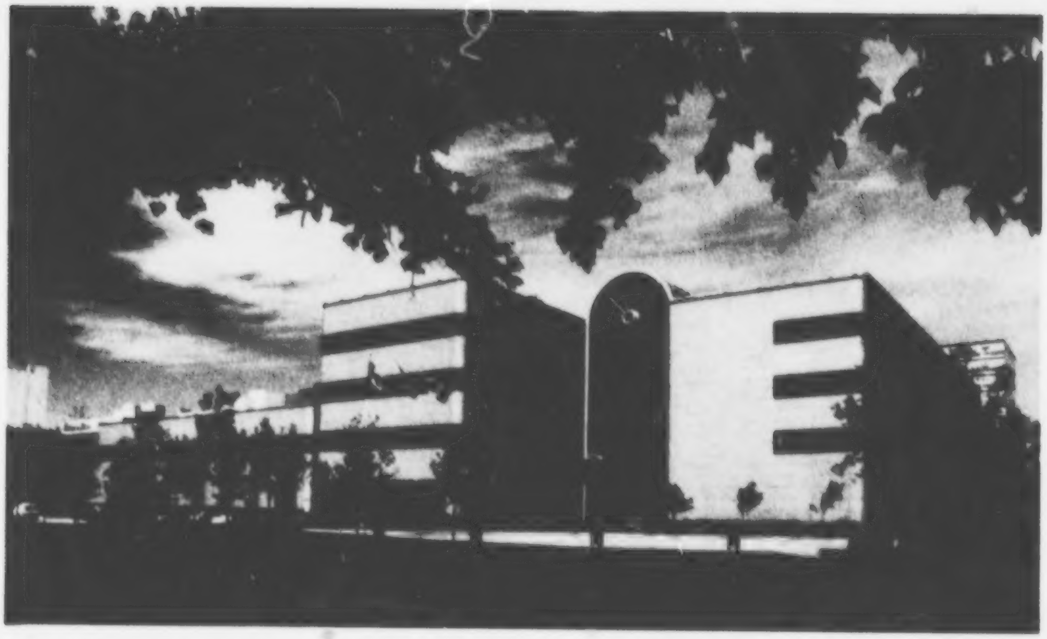
15.69 **Needs definition/options analysis.** The Council's immediate response to the request from the government of Manitoba was to identify the need for an institute. But it did not fully determine the extent to which industry would support the project financially. Nor did it evaluate the consequences that could arise if government support failed to materialize as promised.

15.70 The National Research Council considered several locations in Winnipeg for the site of the Institute. But in line with a Canada-Manitoba Agreement on the redevelopment of the Winnipeg downtown core area, it was directed to locate in the downtown core of Winnipeg. As a result, the Council had to pay about $2.5 million more than the cost of other properties it considered suitable.

15.71 **Project management.** We reviewed the implementation phase of the project and found that the National Research Council, Public Works Canada and Supply and Services Canada generally acted with due regard for economy. But in attempting to meet the objectives of the Special Recovery Capital Projects Program, shortcuts were taken and additional costs were incurred. Work under a $1.6 million consultant's agreement with Public Works Canada began before Treasury Board gave contract approval. Material was purchased in advance of need, resulting in additional inventory costs of approximately $160,000. A contractor claimed additional costs of $95,000 for extra work undertaken to ensure that the project would be completed on time.

15.72 These additional costs, totalling at least $255,000, were incurred as a result of trying to meet the wider government objectives of the Special Recovery Capital Projects Program for a building that has remained mostly unoccupied and unused.

15.73 In the fall of 1984, the government cancelled this facet of NRC's industrial technology program but directed that the building be completed. With the exception of procuring all equipment, the project is finished. Academic and industrial organizations are prepared to participate in the Institute's programs as outlined originally in 1980. But the withdrawal of government resources, for which NRC had approval and which it had designated as a full commitment to the program, means these organizations are reluctant to commit



The National Research Council's Canadian Institute for Industrial Technology in Winnipeg. At the time of our audit the facility was empty (see paragraph 15.70).

themselves. In the meantime, at the time of our audit, the building was largely empty, incurring operating costs of as much as $100,000 a month, which do not include amortization of the capital costs of $28.42 million. This is directly related to the project being cancelled. So the total estimated annual cost of the facility, including $2.8 million for amortization, is $3.8 million.

15.74 We have been informed that the Council has now secured tenants for the building. This will reduce the annual operating cost to government.

Case Study 3. Lake Louise Development Program

15.75 The Lake Louise Development Program is a unique and complex capital program within the Parks Program of the Department of the Environment. The Development Program started as an informal partnership between the Crown and the private sector entrepreneurs operating or seeking to operate in the area. The Crown was responsible for transportation and water and sewage improvements, interpretive facilities (facilities for explaining or interpreting the environment to visitors) and staff housing for government employees. The private sector component also included staff housing, new facilities, and expansion of existing facilities. The Crown was to spend $45 million, the private sector more than $30 million. Completion was originally scheduled for 1987-88 and is currently projected for 1990-91.

Government accommodation for staff members at the Lake Louise Development site (see paragraph 15.88).

15.76 **Options analysis.** In the planning process, three parts of the Lake Louise area that already had some development were considered as alternative sites where development might take place – the valley floor, the lakeside and a nearby ski hill.

15.77 In weighing the relative merits of these three options, the Department considered criteria such as protection of the natural environment, transportation needs, and site characteristics affecting the quality of experiences for the visitor. However, the life cycle costs of these options were not taken into account in opting for the valley floor as the area where development would occur.

15.78 **Program funding.** The submission to Treasury Board for preliminary program approval requested $34.4 million in constant dollars, or $45.6 million in current dollars. An inflation factor of 10 per cent was used in arriving at the $45.6 million, but this was not disclosed in the submission. Treasury Board approved the $45.6 million, with the proviso that preliminary and effective project approvals be sought on a project-by-project basis. In subsequent submissions to obtain these approvals, an inflation factor of 5 per cent was used consistently, but the program cost ceiling was not changed.

15.79 When the inflation factor used in the Treasury Board submissions was reduced from 10 per cent to 5 per cent, the program ceiling should have been recalculated. If this had been done, the program total would have been $39.8 million rather than $45.6 million, a reduction of $5.8 million.

15.80 **Project management.** Construction began in 1980-81. From the outset, the program management structure and controls were inadequate. Deadlines were frequently revised, there was inadequate on-site supervision, and required planning documents for some projects were not prepared on a timely basis or not prepared at all. Appropriate steps to correct the situation, including appointing a full-time program engineer, were not taken until 1984, about mid-way through the Lake Louise Development Program.

15.81 Parks Canada did not establish basic management procedures to provide effective control over program implementation.

15.82 For the Lake Louise Development Program, there is no project monitoring and reporting system that allows managers at appropriate levels to compare physical progress and costs against established milestones on a continuing basis.

15.83 Parks Canada has no evaluation system to measure the success or failure of the projects in meeting the objectives of the Development Program. It does not know, therefore, whether value for money has been achieved.

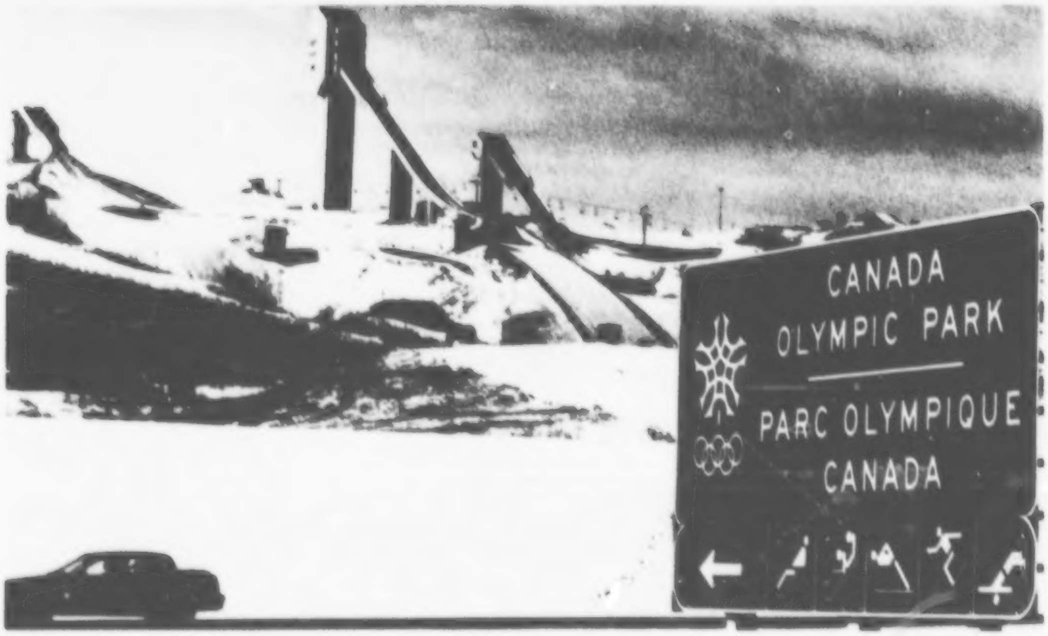
15.84 **Land boundary issues.** A private sector corporation, Canadian Pacific Railways, has railway lines running through the area covered by the Lake Louise Development Program. When the trans-Canada railway was built more than 100 years ago, the government gave the railway financial assistance in the form of substantial grants of land at no cost. Some land was to be dealt with as the railways saw fit ("subsidy lands"). Other lands were granted for use solely for railway purposes, reverting to the Crown should they cease being used for those purposes ("reversionary lands").

15.85 Boundary definitions between Crown and Canadian Pacific lands in the Lake Louise Development area are not clear. The distinction between reversionary and subsidy land in the Lake Louise Development area has been determined only recently by the Department. It has not sought Canadian Pacific's agreement. (An issue regarding reversionary lands in downtown Banff and throughout the National Parks system was dealt with in our 1984 annual Report - Chapter 6, paragraphs 6.90 to 6.93.)

15.86 In the course of the Development Program, the Crown has built on land purportedly belonging to Canadian Pacific Railways on more than one occasion.

15.87 The Department has recognized these issues and has advised us that efforts are under way to resolve them, including clarifying boundary definitions and negotiating with Canadian Pacific Railways to acquire the CPR land on which the Crown has built.

15.88 **Private sector activity.** Our review of departmental documentation regarding private sector work to date revealed a number of deficiencies. Buildings were constructed and occupied before agreements with the Crown were finalized. Rents charged by employers for



The Canadian Olympic Park, Calgary, Alberta, showing the 70 metre and 90 metre jumps (see paragraph 15.91).

staff housing are subject to review and approval by Parks Canada, but this has not been done. Rents charged have sometimes exceeded guidelines set by Canada Mortgage and Housing Corporation. For several years, because of inadequate sewage-handling facilities, Canadian Pacific Railways was polluting the Bow River. Despite repeated requests by Parks Canada, corrective action was taken only recently.

15.89 In our opinion, private sector development is not being controlled adequately.

15.90 The Department of the Environment should determine whether these problems result from non-enforcement of existing regulations and guidelines, or whether the controls in place are inadequate. Appropriate action should then be taken to enforce or strengthen existing controls or to implement new ones if necessary, to ensure that departmental objectives with respect to the Lake Louise Development Program area are met during the construction period and in the future.

Case Study 4. Canada Olympic Park

15.91 This project consisted of building facilities for the ski jumping, bobsled and luge competitions in time for the 1988 Olympic Winter Games, at an estimated cost of $62.2 million (1982-83 dollars). The work had to meet the requirements of Fédération internationale de Ski, Fédération internationale de Bobsleigh et Toboganning, Fédération internationale de Luge, and the International Olympic Committee. In addition, the federal government directed that there be a lasting legacy for the benefit of Canadian amateur athletes.

15.92 **Project management.** We visited the site and examined the project files and documents in the Office of the Federal Co-ordinator for the Games (who reports to the Deputy Minister, Health and Welfare Canada) and in the Department of Public Works. We concluded from our audit work that this complex project was well managed.

EMERGENCY PREPAREDNESS

Introduction

15.93 The release of toxic chemicals in Bhopal, India, the Mexico City earthquake, and the accident at the Chernobyl nuclear generating station have reminded Canadians of the potential effects of natural and man-made disasters.

15.94 In Canada, the municipal, provincial and federal governments share the development and implementation of plans to deal with emergencies. The first responsibility for responding to an emergency rests with the municipality. As larger emergencies overcome the capacities of municipalities, responsibility passes to provincial governments and, if the problem is beyond their capacity, a further obligation to respond is added, this time to the federal government.

15.95 In the federal government, responsibility for emergency preparedness is shared between Emergency Preparedness Canada, and each federal department, agency and Crown corporation. In 11 of these, there are special planning responsibilities for structures called National Emergency Agencies.

15.96 Canada's arrangements for peacetime emergencies are therefore highly decentralized in terms of how, where, and by whom preparations are to be made.

Background

15.97 Present arrangements for emergency preparedness at the federal level have their roots in the centralized civil defence activities of the 1950s and early 1960s. Programs established then are still in operation today.

15.98 In the late 1950s, federal preparations for civil defence were centred in the Emergency Measures Organization. This organization was given responsibility for co-ordinating civil defence planning in federal departments. The focus of federal attention was the risk of a nuclear attack on North America.

15.99 In the 1970s the federal government commissioned Lieutenant General M.R. Dare to study federal crisis handling capacity. The Dare report - "The Enhancement of Crisis Handling Capability within the Canadian Federal Structure" - was presented to the government in October 1972 and was tabled in the House of Commons in condensed form in March 1974.

15.100 The government accepted the foremost recommendation that federal departments and agencies should retain primary responsibility for handling emergencies falling within their areas of responsibility. It also accepted the need expressed in the report for some measure of federal involvement in peacetime emergency planning.

15.101 During the 1970s, responsibility for policy and the coordination of federal emergency planning was divided between the Privy Council Office and the Department of National Defence. A small secretariat in the Privy Council Office provided policy assistance to the responsible Cabinet Committee and passed ministerially-approved tasks to the Emergency Measures Organization in the Department of National Defence.

15.102 In November 1980 the government announced a new federal policy for emergencies that included peacetime concerns as well as civil defence. The objectives of the policy were:

- to provide leadership in working towards improved emergency preparedness in general;
- to develop a credible national capability to meet emergencies of all types;
- to work towards an adequate and reasonably uniform standard of emergency services across the country; and
- to be sensitive to humanitarian concerns.

15.103 In 1980, the Cabinet assigned Emergency Planning Canada (succeeded in 1986 by Emergency Preparedness Canada) responsibility for comprehensive planning, policy development and policy co-ordination, in co-operation with the Interdepartmental Committee on Emergency Preparedness. Emergency Preparedness Canada is also charged with the overall co-ordination and administration of two programs of financial assistance to the provinces. Emergency Preparedness Canada is administratively supported by the Department of National Defence but reports direct to the Minister Responsible for Emergency Preparedness and operates with considerable independence.

Emergency Planning Order

15.104 In 1981, the Governor In Council issued Emergency Planning Order 81-1305. It assigns to all ministers general emergency planning duties. Part I of the Order In Council assigns specific responsibilities to certain ministers for National Emergency Agencies. Part II of the Order In Council assigns additional responsibilities unique to war to a number of Ministers of which three also have National Emergency Responsibilities. Implementation of any emergency plans not authorized by existing laws would require Parliament's approval through new legislation.

15.105 Because the effects of an emergency may be felt in other responsibility areas, in addition to where it began, ministers must also be prepared to provide assistance to any colleague minister who may be assigned responsibility for handling an emergency.

15.106 Eleven ministers are assigned unique responsibilities by the Order In Council. They must establish plans for National Emergency Agencies. The Order In Council calls on those ministers to prepare for establishing National Emergency Agencies so that they may function effectively "in any region of Canada in time of national emergency...". These agencies may come into being, as needed, when a "national emergency" is declared by the Governor In Council. They would call on the resources of the department to which they belong, other federal departments and if the situation is sufficiently serious, all national resources.

15.107 The National Emergency Agencies are intended to manage critical national resources during a national emergency such as a major nuclear accident, earthquake, the release of toxic chemicals and war. The Order does not define the words "national emergency". However, it defines "emergency" as an "abnormal situation that requires prompt action beyond normal measures to prevent or limit injury to persons or damage to property or the environment".

15.108 The National Emergency Agencies are dual-purpose organizations and are intended to be ready for possible use in national emergencies arising out of normal, that is, "peacetime", conditions, and those arising out of war or events leading to war. Where possible and desirable they are expected to secure the co-operation and help of the private sector and the provinces.

Audit Scope

15.109 We examined the planning for National Emergency Agencies in respect of the Emergency Planning Order to determine whether satisfactory procedures had been established to measure and report the effectiveness of the programs and whether money had been spent with due regard to economy and efficiency. The National Emergency Agencies are designed to operate in peacetime or wartime. We audited the peacetime aspect.

Specifically, we examined:

- the legislative authority and organizational structure for federal peacetime emergency planning; and
- the extent to which the 1981 Emergency Planning Order had been implemented in setting up the National Emergency Agencies.

15.110 We did not review the wartime responsibilities of the National Emergency Agencies as defined in the Emergency Planning Order but developed an understanding of how those wartime duties related to the peacetime side. We also did not review planning for other than major emergencies.

15.111 We inquired whether federal emergency plans existed so that the federal government, if called on, could meet its responsibilities in responding to major nuclear and chemical accidents, and earthquakes. In carrying out this review, we relied on departmental studies and reports.

Organization

Prime Minister

15.112 The Prime Minister is ultimately responsible for ensuring that Canada is prepared to deal with emergencies of major proportions. He is responsible for managing and co-ordinating national information services that would provide general guidance and direction to the public in cases of national emergency.

15.113 If an emergency should arise in which the federal responsibility is not clear, the Prime Minister may designate a minister (a department) to assume "lead" responsibilities. So far, the departments of National Health and Welfare, the Solicitor General and National Defence have been nominated in advance to facilitate preparations for specific types of emergencies.

Minister Responsible for Emergency Preparedness

15.114 To assist with his responsibilities the Prime Minister may appoint a Minister Responsible for Emergency Preparedness. The current appointment is held by the Minister of National Defence but any minister may be designated.

15.115 The Minister Responsible for Emergency Preparedness is supported by an Interdepartmental Committee on Emergency Preparedness for policy and co-ordination, as well as by Emergency Preparedness Canada itself.

15.116 From time to time the minister meets with his provincial counterparts to discuss emergency preparedness issues. The last federal-provincial meeting of ministers took place in February 1986 in Ottawa.

Emergency Preparedness Canada

15.117 The Emergency Preparedness Canada budget for 1986-87 was $11.7 million. Emergency Preparedness Canada states that because the amount of money which may be required is unpredictable, the Disaster Financial Assistance Program to the provinces is not budgeted. In 1986-87, $11.84 million was spent on assistance to the provinces. The personnel complement was 93 person-years.

15.118 Its role, as described in Part III of the 1986-87 Estimates, is to be responsible for stimulating, facilitating, and co-ordinating federal emergency planning activity. Working with other levels of government to prepare for emergencies, Emergency Preparedness Canada also "aims to enhance national emergency response capability by establishing adequate and reasonably uniform emergency services across the country".

15.119 In practice, Emergency Preparedness Canada is the federal agency responsible for federal policy development, inter-departmental co-ordination and the provision of planning and training support to provincial governments on request. It also carries international responsibilities relating to Canada's commitments to the North American Treaty Organization and to Canada-United States joint interests in co-operative emergency preparedness.

15.120 However, Emergency Preparedness Canada has no authority over officials of other federal departments. It must carry out its task by persuasion. This is also true of its dealings with the provinces, some of which have highly developed emergency preparedness agencies.

15.121 Federal emergency policy and the role of Emergency Preparedness Canada are based on the premise that "initial responsibility for handling emergencies normally rests with those directly affected". This principle is reflected in Memoranda of Understanding signed with seven provinces and two territories so far. These Memoranda are being developed to provide a framework for intergovernmental co-operation.

15.122 Along with its co-ordination and secretariat role, Emergency Preparedness Canada also carries significant responsibilities for wartime planning.

Interdepartmental Committee on Emergency Preparedness

15.123 To meet its obligation to co-ordinate, Emergency Preparedness Canada brings departmental representatives together in a number of committees, of which the most senior is the Interdepartmental Committee on Emergency Preparedness. This committee is chaired by the Executive Director of Emergency Preparedness Canada, and one of its responsibilities is to oversee the implementation of Cabinet decisions concerning emergency preparedness.

15.124 Established when the secretariat function for emergency planning was located in the Privy Council Office, the committee was supposed to be composed of assistant deputy ministers from 17 federal departments and agencies. It now meets on an as-needed basis and most assistant deputy ministers now delegate their attendance to lower-ranked departmental representatives.

National Emergency Agencies

15.125 The authorizing Order In Council assigns powers, duties, and functions to 11 National Emergency Agencies with regard to national emergencies. Each National Emergency Agency exists as a plan on paper, maintained by minimal staff resources, until an emergency arises calling for the plan to be activated. The Agency would then be authorized into operation under federal authority. At the time of our audit, the only general federal statute authority was the War Measures Act, which may be an awkward instrument in peacetime national emergencies.

15.126 Listed below are the 11 departments and agencies with responsibility for planning the National Emergency Agencies.

Department/Agency	**National Emergency Agency for:**
Agriculture	Food
Communications	Telecommunications
Employment and Immigration	Human Resources
Energy, Mines and Resources	Energy
Finance	Financial Control
Health and Welfare	Health and Welfare Services
Regional Industrial Expansion	Industrial Production
Prime Minister	Public Information
Public Works	Construction
Canada Mortgage and Housing	Housing and Accommodation
Transport	Transportation

15.127 Five of the 11 National Emergency Agencies have international responsibilities arising from Canada's NATO commitments and from our relations with the United States.

15.128 A few other federal departments support Agency planning. For example, the Department of Agriculture is supported by the Department of Fisheries and Oceans, while Employment and Immigration works closely with the Department of Labour. Departments may also be involved with co-ordinating their activities with the provinces, and through them, down to the municipal level.

15.129 The combined plans for the National Emergency Agencies can be viewed as the federal program reserved for national emergencies.

Observations

Authority and Organization

15.130 The co-ordinating agency for emergency preparedness in the federal government, Emergency Preparedness Canada, has no statutory authority. It is not mentioned in the Order In Council for Emergency Planning. Its co-ordinating role with respect to National Emergency Agencies is not clearly defined.

15.131 Until recently, the assignment of priorities and resources for National Emergency Agencies that are national in scope has been left in the hands of departments whose interests and priorities are more narrowly focused. There are no clear arrangements for inter-departmental direction from other levels of authority.

15.132 The role of the Interdepartmental Committee on Emergency Preparedness in developing and testing National Emergency Agency plans is not clearly defined.

15.133 Finally, except for the War Measures Act, there was no general standing statutory authority for the federal government to declare an emergency in peacetime that would provide it with the authority to fulfil its responsibilities.

15.134 It should be noted that, under the Energy Supplies Emergency Act (1979), the Energy Supplies Allocation Board in the Department of Energy, Mines and Resources is authorized to develop contingency plans to respond to disruptions in the international oil market as a particular national emergency.

Implementation

15.135 The Order In Council and the surrounding arrangements provided for no deadline by which the plans for the National Emergency Agencies were to be ready. Progress is not reported according to a schedule.

15.136 The 1986 Annual Review of Emergency Preparedness Canada states that "by the end of the decade all departments should have developed their plans and arrangements to the point where (their) plans will be able to be tested in national exercises and used if necessary." It also states that almost all Agencies have passed the first milestone, the "articulation of concepts of operations."

15.137 The conclusions about the first milestone and the "end of the decade" expectation were reached without formally consulting the departments responsible for the National Emergency Agencies.

15.138 We found it difficult to assess progress toward the development of National Emergency Agency plans because no milestones had been established. It is not clear how many milestones there are and what they are.

15.139 No formal system of "national" hazard or risk assessment is in place that would permit co-operative federal-provincial planning and federal inter-departmental planning for potential peacetime national emergencies.

Accountability

15.140 The status of National Emergency Agency plans are not reported regularly in a formal, standardized way either to the Minister Responsible for Emergency Preparedness or to Parliament.

Examples of Possible National Emergencies

15.141 We asked departments responsible for planning the National Emergency Agencies whether the federal government, in its preparedness planning, had formulated or was preparing co-ordinated plans to deal with disasters on the scale of Chernobyl, the Mexico City earthquake, or the Bhopal chemical release. Our underlying assumption was that the federal government's role would be to act in co-operation with other levels of government.

15.142 The strategy used by current federal emergency planning is described by Emergency Preparedness Canada as the "all-hazard" approach. Emergency Preparedness Canada explains that the planning system recognizes that the effects of emergencies are similar or alike (i.e., all-hazards) whatever the cause. There are medical, social, physical, and communications problems, for example, that must be met in many emergencies. Planning, therefore, focuses on developing those individual preparedness arrangements. Although we recognize the utility of this approach in terms of resource utilization, we believe it could be supplemented by preparing plans for drawing together and co-ordinating the appropriate combinations of elements to respond to specific kinds of national emergencies.

15.143 Major disasters, although of low probability, could occur. If they did, their severity would require co-operation between the federal government and the province or provinces affected. In turn, this could involve activating one or more of the National Emergency Agencies, which are designed to respond to national emergencies.

15.144 We found that National Emergency Agency planning for peacetime emergencies concentrates on the specific responsibilities assigned by the Order in Council. These in turn are based on existing departmental duties. Co-ordinated planning for national emergencies of the type mentioned, which would cut across departmental lines, is not apparent.

15.145 The process of preparing for a national emergency highlights the dilemma facing senior management and emergency planners everywhere - how many resources are to be applied to events of low probability but of high risk to both people and property? Judgements must be made on the basis of risks and the availability of resources.

15.146 At the federal level, there is little rigorous risk analysis or the development of worst-case scenarios that would help decide what national peacetime emergency is likely to require the help and resources of the federal government.

15.147 Planning for potential and specific "national" disasters does not exist. There is little federal planning co-ordination among the National Emergency Agencies, or between them and Emergency Preparedness Canada, for such potential large scale disasters as a nuclear accident, an earthquake, or the release of toxic materials. It is not specified who would co-ordinate the National Emergency Agencies involved, even in the initial phase of the emergency, should any major disaster occur.

Nuclear Accidents

15.148 The Department of National Health and Welfare has prepared a Federal Nuclear Emergency Response Plan. This plan had not been tested before the Chernobyl incident, whose effects on Canada were slight. However, as a result of the experience with that emergency, the Department commissioned a report. In the context of a national emergency and the National Emergency Agency for Health and Welfare, the report noted these deficiencies:

- The federal nuclear response plan is not the responsibility of the officer responsible for departmental emergency planning and National Emergency Agency planning for the department. That officer was kept on the fringes of the action, had difficulty making contact with the departmental unit responsible for informing the public about radiation, and had to contact Emergency Preparedness Canada for information.
- Emergency Preparedness Canada was not identified as a core member of the Federal Nuclear Emergency Response Plan.
- The objectives of the Federal Nuclear Emergency Response Plan and the means to achieve them were not clearly defined.

15.149 Overall, the commissioned study drew attention to internal federal government criticism of National Health and Welfare's management of the Federal Nuclear Emergency Response Plan. Criticism was directed largely toward the communication system, public information methods, deficiencies in radioactivity reference standards, and to the failure to follow the Response Plan.

Chemical Accidents

15.150 As a result of the Bhopal accident, the federal Department of the Environment, which is paradoxically not a National Emergency Agency department, undertook at its Minister's initiative to assess the adequacy of existing measures to prevent or respond to similar major industrial accidents in Canada. This assessment was made in co-operation with private and public sector organizations. The Department issued a report, "Bhopal Aftermath Review: An Assessment of the Canadian Situation", in March 1986.

15.151 The report provides an overview of measures taken by industries and governments to prepare for, and respond to, major chemical accidents in Canada. It identifies gaps or needs. For all levels of government, the report suggested that significant improvements could be made in:

Evacuation scene: chemical accident.

- prevention and readiness;
- hazard analysis;
- response capabilities; and
- upgrading the skills of emergency personnel throughout the system.

15.152 In addition to Environment Canada, the Department of Transport regulates the transport of dangerous goods across provincial and national boundaries. It maintains a Canadian Transport Emergency Centre (CANUTEC) which can provide immediate advice and scientific data to those responding to emergencies involving dangerous goods. The Centre can also provide other technical assistance and would be available in the case of a major chemical accident.

15.153 We recognize that the issue of potentially serious chemical accidents is complex and involves major co-ordination problems. One would expect, however, that it would be treated as a possible national emergency for which co-ordinated federal-provincial plans could be prepared. At present there is no evidence that this is being done.

Effects of an earthquake.

Earthquakes

15.154 Emergency Preparedness Canada believes that much of the all-hazards type of planning would be applicable for major earthquakes. However, little has been done in the field of federal emergency preparedness specifically in respect of earthquakes. General geological studies to identify areas at risk have been made but these have not been linked to national emergency planning. An earthquakes seminar was sponsored in 1981 by the Province of British Columbia and Emergency Preparedness Canada. Some federal departments have listed some of the physical resources and expertise they can make available in case of an emergency but not for earthquakes in particular.

Recommendations

15.155 Inter-departmental co-ordination for national emergencies should be significantly increased.

15.156 Risk assessment should be conducted to determine what potential specific national emergencies or hazards require the development of plans; to identify current response capabilities; and to determine the nature and level of federal support that may be required.

> ***Emergency Preparedness Canada's response:*** *Emergency Preparedness Canada states that this recommendation's reference to "specific national*

emergencies" reflects an apparent preoccupation with the factors which cause an emergency rather than the consequent effects. The effects of disasters tend to be similar in nature, regardless of the cause, and vary from emergency to emergency only in their relative importance or severity. People are made homeless, people must be fed and given medical attention; transportation and communications problems develop, areas may need to be evacuated, to cite a few of the effects common to many emergencies.

The similarity of the effects of emergencies, coupled with the organization of the federal government on functional lines and the division of responsibilities in a federal country, lead to the conclusion that the most effective and efficient structuring of federal emergency preparedness is one based on effects rather than on causes. The department best able to deal with housing problems, or health problems, or transportation problems is required to plan to do so, regardless of the cause of the problem. This is the essence of the federal government's "all hazards" approach to emergency response. The people most knowledgeable about a particular effect deal with it, using the specialized resources of the department or agency whose normal functions are most closely related.

The need for an all hazards approach is reinforced by the federal-provincial dimension. When governmental action is required in an emergency, the responsibility for providing assistance passes first to the municipality affected, then to the province, then to the federal government. Given this established sequence of responsibility, which the provinces are most anxious to have observed, the federal government becomes involved in emergency response only when requested to do so by a province or when aspects of the emergency clearly fall within federal jurisdiction. The nature and level of federal assistance needed varies significantly from occasion to occasion, depending on the severity of the emergency and on local and provincial capabilities, but generally it is support in meeting particular effects which is asked for.

While risk analysis at the national level is helpful in determining the likely distributions of the demand for federal involvement, with regard to the nature, scale and location of the assistance needed, this analysis is not required with the same precision as is needed by those responsible for emergency response in the first instance.

15.157 Goals and deadlines should be established for the completion and testing of plans for National Emergency Agencies.

***Emergency Preparedness Canada's response**: EPC agrees with this recommendation.*

15.158 National Emergency Agencies should annually report their goals and progress toward those goals to Parliament.

***Emergency Preparedness Canada's response**: This recommendation will be accommodated by an annual report to Parliament which the Minister Responsible*

> *for Emergency Preparedness will be required to make under the Emergency Preparedness Act tabled in the House of Commons on June 26th.*

15.159 The designation of lead departments for specific national emergencies should be updated to ensure that the most appropriate departments have been identified.

> ***Emergency Preparedness Canada's response**: This recommendation also refers to "specific national emergencies" and hence the response to the first recommendation applies here as well. In any case, the appropriateness of the particular responsibilities for which departments have been designated is reviewed regularly, as is the feasibility of new designations.*

15.160 The duties of the major federal responsibility centres – the Minister Responsible for Emergency Preparedness, Emergency Preparedness Canada, the Interdepartmental Committee on Emergency Preparedness, and the respective ministers responsible for National Emergency Agencies – should be re-examined and their respective responsibilities defined.

> ***Emergency Preparedness Canada's response**: This recommendation is met by provisions of the Emergencies Act and the Emergency Preparedness Act, both of which were tabled in the House of Commons by the Minister Responsible for Emergency Preparedness on June 26th.*

15.161 Consideration should be given to providing statutory authority for federal emergency planning and for the government to declare a national emergency in peacetime.

> ***Emergency Preparedness Canada's response**: This recommendation is met by provisions of the Emergencies Act and the Emergency Preparedness Act, tabled in the House of Commons on June 26th.*

15.162 Co-ordination and the testing of specific national emergency plans - between federal entities and between the federal government and the provinces - should be made the responsibility of a designated federal agency.

Addendum

15.163 Subsequent to the conclusion of this audit the government, on 5 June 1987, tabled in the House of Commons its White Paper – "Challenge and Commitment - A Defence Policy for Canada" in which it announced its intention to introduce comprehensive legislation to deal with the full range of possible national emergencies.

15.164 On 26 June 1987, the Minister responsible for Emergency Preparedness introduced draft federal emergencies legislation into the House of Commons – the Emergencies Act, and the Emergency Preparedness Act – and announced that the federal government would be repealing the War Measures Act. Simultaneously the government revoked the Emergency Planning Order.

15.165 To cover the interim period until the Emergency Preparedness Act is passed, Cabinet has directed federal departments, agencies and Crown corporations to continue planning for emergencies in accordance with current government policy and the spirit of the provisions of the Emergency Preparedness Act.

15.166 Some of the observations made in this report may be of relevance to the proposed new arrangements.

MICROCOMPUTER STUDY

Introduction

15.167 The past five years have been marked by rapid growth in both the capability of the microcomputer and its acceptance in government for new forms of office automation. Today's microcomputers rival the computing capability of the government's mainframe computers of 20 years ago.

15.168 As of March 1986, Treasury Board Secretariat estimates that the Federal Government had about 12,000 microcomputers. The initial cost of this equipment would have been approximately $60 million. This represents almost one-quarter of all reported computer workstations in the federal government; thus the microcomputer is a significant component of the government's overall computing capability.

15.169 When considering the potential benefits of microcomputers it is important to realize that the initial capital investment in these machines is only the beginning. Costs to bring the hardware into productive use can be up to six times the initial purchase price. Ongoing additional costs come from the need to give users technical support, training, and time to experiment, develop and perfect applications. Because individual microcomputer solutions should ideally evolve into common systems for staff performing the same tasks, there is a further cost associated with building individual microcomputer systems into common applications for larger groups of staff.

Audit Objective and Scope

15.170 In 1985 Treasury Board Secretariat issued a policy detailing measures for the acquisition and utilization of microcomputers in department and agencies. These measures addressed issues pertinent to the management of microcomputer technology. Given the major influx of microcomputers into government, our purpose was to assess how well the new microcomputer technology was being managed in some departments. We wanted to see whether the departments were realizing the benefits available and whether they were controlling the risks inherent in acquiring and using microcomputers.

15.171 We did not audit the use of other forms of workstations such as computer terminals and special-purpose word processors. Other components of office automation, telecommunications, for example, were not examined.

15.172 We audited the use of microcomputers in five organizations:

- Agriculture Canada;
- National Revenue - Customs and Excise;
- Energy, Mines and Resources;
- Statistics Canada; and
- Transport Canada.

15.173 We also interviewed Treasury Board and Department of Supply and Services personnel.

Observations and Recommendations

General Assessment

15.174 The introduction of microcomputers differs from that of large computers because of the availability of an extremely wide variety of relatively low unit cost products for almost every imaginable use. Microcomputers are being used for a variety of purposes in the departments we examined:

- word processing;
- spreadsheet data analysis and modelling;
- drafting and graphics applications;
- scientific applications;
- specifically developed applications; and
- terminals to mainframes and minicomputers.

15.175 The introduction of microcomputers has generally had a positive effect on the work performed. In our opinion, microcomputers have demonstrated their ability to be an important addition to the family of computer technology available to streamline government operations. In our audit we observed numerous cases where the microcomputer has offered a relatively simple means of improving the efficiency and effectiveness of operations – at costs and within time spans far less than would have been needed in the past using large computer systems. Given the difficulties in controlling large government computer projects, we believe the microcomputer has a very significant role to play.

15.176 However, in our review we have found that microcomputer technology is not yet sufficiently well planned and controlled to ensure that the full potential of this important tool is realized.

15.177 At present, there is little assurance that the government is realizing the potential benefits from its investment in this technology. Managers are generally not measuring its effects on productivity. Microcomputers are acquired primarily in response to individual staff requests, not as a part of any overall plan for the development of computing in departments. There is a need to improve training, support and guidance for microcomputer users. We found that departments were not paying enough attention to security and control of data on microcomputers and that software copying policies were not being monitored or enforced effectively.

Experimentation and Innovation

15.178 In the early stages of applying any new technology, a certain degree of controlled experimentation and innovation is required. We expected to find that microcomputers were being introduced in a way that encouraged controlled experimenting and innovating. And we looked for evidence that the introduction of this new technology was resulting in the development of strategies for common use and in the dissemination of successful applications throughout a department.

15.179 Departments are doing a lot of experimenting and innovating with microcomputers. In some cases, this process had advanced to the point where applications of common use were being disseminated throughout departments. For example, in Statistics Canada, a user in one of the regional offices developed a staff scheduling system. It won a departmental suggestion award and was subsequently documented and distributed to other regional offices for their use.

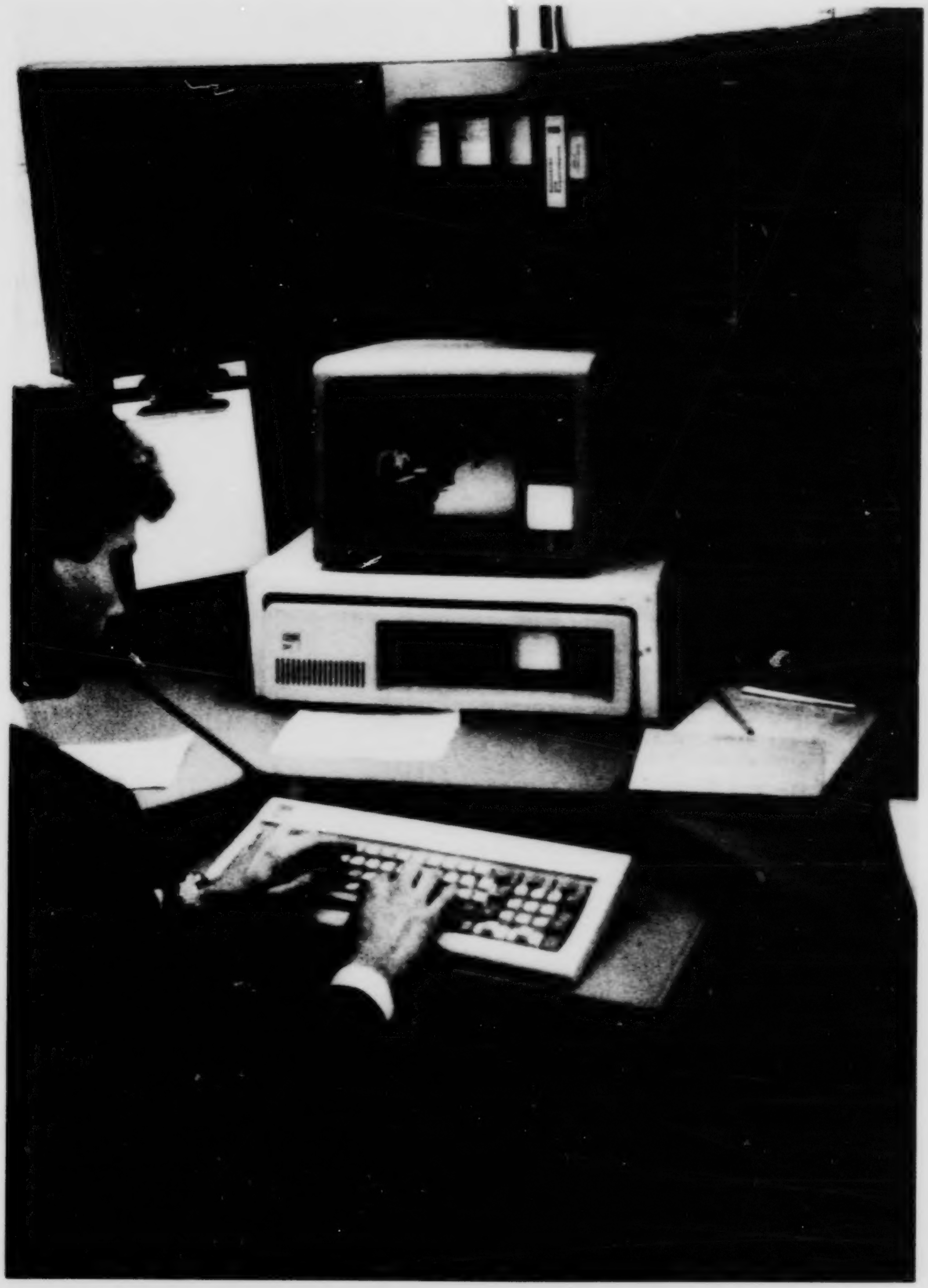
15.180 The Department of Transport is developing a new Multipurpose Information Display System involving a network of 250 microcomputers across Canada. It is replacing manual processes that made use of wall maps, teletype messages and clip boards. The Department finds that the microcomputers are providing more current information and better service to pilots in preparing their flight plans and while in flight. The intended result is improved aviation safety, particularly in severe weather conditions.

Efficiency and Effectiveness Improvements

15.181 Investment in microcomputer technology should result in improved efficiency and effectiveness of departmental operations. Managers in departments using microcomputers need to be aware of the impact this technology will have on their operational performance.

15.182 In many cases, the use of microcomputers has led to significant changes in the work accomplished. Tasks are being carried out more quickly and efficiently, more data is analysed and better quality information is being produced. Much of the increase in productivity comes from improved personal performance as staff use off-the-shelf software such as word processing and spreadsheets to do their work faster and better. In other cases, systems have been built by users who have taken advantage of their personal computers to design systems that carry out the business of the department better.

15.183 For example, Transport Canada's Vehicle Fleet Management System uses microcomputers to increase productivity. The Department has found that its initial investment of $31,000 has allowed it to automate records related to current fleet inventories and operating information. Management reports are now produced on demand. This has enabled the organization to improve the quality of fleet management and reduce the clerical work of various staff members. Based on the information provided, we estimate savings in excess of $60,000 per year.



An employee using a microcomputer to provide meteorological and flight information to aircraft pilots (see paragraph 15.180).

15.184 Transport Canada also uses microcomputers to prepare contract documents. Technical and engineering staff can create, edit and update tendering documents in less time than before. They avoid having to annotate draft copies, send them to a word processing operator and then proofread the results. The graphics capabilities of microcomputers mean that staff can often prepare diagrams without needing drafting skills.

15.185 We also saw productivity gains in other departments. In Agriculture Canada, microcomputers allow laboratory results to be analysed in 26 minutes rather than 36 hours. And Energy, Mines and Resources installed a microcomputer network at an initial cost of $225,000, leading to a reduction in service bureau and operating costs of $520,000 a year.

15.186 But some projects based on microcomputers have been less successful. Most of these were experiments that did not result in usable systems. We did not find evidence of widespread waste of funds on microcomputer projects. But experimentation, training and introduction time involving all levels of staff can lead to large indirect personnel costs. We are concerned that management may not be aware of the overall costs associated with introducing this technology.

15.187 We also saw no evidence that management has examined the impact of investing in microcomputers. Industry experience has shown that it is difficult to assess the costs and benefits of individual microcomputer acquisitions; introducing microcomputers frequently leads to significant changes in the way work is carried out. It also leads to such benefits as faster turnaround times, improved accuracy and higher quality output. But even though the task is not easy, organizations need to assess overall costs and benefits that result from using microcomputers over time so they can be assured that their investment, which in most cases is substantial, is having the intended results. Despite initial successes, there is no guarantee that aggregate investment in microcomputers is resulting in increased productivity.

15.188 **Departments should assess the overall effect of microcomputers on the efficiency and effectiveness of their operations with a view to ensuring that they are getting value for their investment.**

Planning and Integration

15.189 Microcomputer applications are part of a department's total information technology arsenal. Acquiring and using them should be treated in this context. We found, however, that most microcomputers were purchased one at a time. And most microcomputer applications were developed by individual users. Although departmental information technology plans contained microcomputer hardware purchases, they seldom specified their use.

15.190 We found that many users have automated their manual financial systems on microcomputers. But this was often done in isolation from central departmental financial systems, leading to duplication of data entry effort. Timely information did not flow between these systems, and there is the possibility that different versions of information will be in the various systems, particularly if they are not reconciled.

15.191 In one area of Energy, Mines and Resources, managers developed a spreadsheet-based financial system for their group. They continued to provide input to the departmental financial system, but used the reports generated by the central system mainly for reconciliation. They considered the information in their microcomputer system more timely and useful.

15.192 Departments should include the use to be made of microcomputer applications in their information technology strategies.

Guidance and Support

15.193 The introduction of new technology requires significant training and support. Appropriate skills have to be developed and staff have to be re-allocated to achieve overall gains in an organization's efficiency and effectiveness.

15.194 We found that several techniques were used to introduce microcomputers. For example, special technical support groups were established; more advanced users were giving assistance to the less experienced.

15.195 Departments have addressed the need to provide a base of technical expertise to evaluate and support the rapidly changing field of new microcomputer products. A central microcomputer support group existed in each of the five departments examined. For example, they typically:

- provided product evaluation and research;
- operated a demonstration centre where users could test and evaluate new products;
- provided advice on acquisition, installation and maintenance;
- rented units to users;
- operated a hotline for users with problems; and
- published a monthly newsletter.

15.196 But even though central microcomputer support groups were providing assistance, they were unable to keep up with users' demands for their services. In our view, these central groups perform a valuable role but must be supplemented with appropriate skills in the office work force in order to support microcomputer systems properly.

15.197 The changing role of clerical and secretarial support staff has yet to be addressed by government departments. As office staff begin to use microcomputers in their work, the need for secretarial and typing support shifts to the requirement to provide technical help direct to microcomputer users. This has a far-reaching impact on the nature and definition of support staff work as well as on the ability of departments to derive achievable benefit from the substantial investment being made in microcomputers.

15.198 Departments should assess the traditional roles of office support staff and initiate action to ensure that staff acquire the skills necessary to take full advantage of microcomputer technology.

Procurement

15.199 The procurement of microcomputers, accessories and software should be made with due regard to economy. Purchasing procedures for individual microcomputers lead to competitive tendering for comparable products in an extremely competitive marketplace. From our review of procedures, we believe that microcomputers are generally being purchased with due regard for economy.

15.200 One means of reducing the unit cost of software is to negotiate "site" licenses for multiple copies of a software package. The potential reduction of the unit cost of software purchased is as much as 50 per cent. This method is practical when large numbers of microcomputer users group their purchasing requirements. Strategies for standardizing software packages allow for these potential economies. Despite the large population of microcomputers in government, we encountered little evidence of bulk purchasing or "site" licensing of software.

15.201 Departments should investigate the use of bulk purchase or site licensing agreements for microcomputer software.

Security and Control

15.202 The microcomputer introduces a new technological environment for storing classified information and controlling computerized operations. Microcomputers are used primarily in the office, rather than in large computer centers. We have the same concerns as with large computer systems, but the widespread use of microcomputers has the potential for more risk. And the practical means of providing adequate security and control are different.

15.203 Microcomputers that process and store sensitive or classified information require adequate protection against unauthorized access. In addition, for systems that produce information used to make critical decisions, appropriate procedures should exist to ensure processing and data integrity, back-up and documentation. Although most managers we interviewed were aware of the potential for security and control problems with microcomputers, we found little evidence of specific departmental action to address these issues.

15.204 Departments should assess the security and control risks associated with their microcomputer systems and institute measures to ensure adequate processing controls and levels of protection over the information contained in them.

Software Copying Policies

15.205 Policies exist on the use, transfer and copying of commercial software packages. Most microcomputer software packages are procured under a vendor agreement that carries restrictions regarding transferring, copying, duplicating and distributing. We found instances where these policies were not being monitored or enforced effectively. Consequently, we are concerned that the government could be exposed to liability for unauthorized use.

15.206 Departments should take steps to ensure compliance with policies regarding the transfer, copying and duplication of software.

FOLLOW-UP OF RECOMMENDATIONS IN PREVIOUS REPORTS

FOLLOW-UP OF RECOMMENDATIONS IN PREVIOUS REPORTS

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Exhibit

16.1 Canada Pension Plan Unidentified Contributions Held in Suspense

16

FOLLOW-UP OF RECOMMENDATIONS IN PREVIOUS REPORTS

Introduction

16.1 As in our 1985 and 1986 annual Reports we are reporting on the status of action taken by departments and agencies in response to this Office's observations and recommendations.

Scope

16.2 This year we completed follow-up audits or reviews on important recommendations contained in five chapters from the 1985 Report. In all cases, we designed the scope of the audit to permit us to arrive at an overall conclusion on the effectiveness of the action taken in response to our observations and recommendations.

16.3 As discussed in more detail in the section of this chapter on the Department of Regional Industrial Expansion we supplemented our follow-up by carrying out audit work on a sample of projects approved since our 1985 audit. We did this in order to ascertain whether the actions taken by DRIE had resulted in improvements in program delivery.

16.4 In our 1986 Follow-up Chapter we included an initial assessment of the progress made by the Department of National Defence in response to our 1984 recommendations. Chapters 9 and 10 of this Report include comments on the results of more detailed follow-up of those recommendations dealing with major capital projects and materiel support. The Department has responded positively to these recommendations.

Current Status

16.5 The status of actions taken in response to our recommendations varies considerably. The position in respect to each follow-up is set out later, but highlights include:

16.6 **Public Pension Management** - All our observations received serious consideration .... In some areas there have been significant improvements. In many other important areas, however, progress has been disappointing.

16.7 **Mixed and Joint Enterprises** - The quantity and quality of information on the purpose, nature and extent of the government's participation in mixed and joint enterprises have improved since 1985. But improvements are still possible.

16.8 **Atomic Energy Control Board** - The Board has responded positively to our recommendations.

16.9 **Department of the Environment, Atmospheric Environment Service** - The Service has made progress in the direction of the needed management improvements, but further work needs to be done.

16.10 **Department of Regional Industrial Expansion** - The Department has attempted to address the observations and recommendations in our 1985 Report. Although there have been improvements in several areas, some of the problems in program delivery that we criticized in 1985 are still evident.

Public Pension Management - 1985, Chapter 4

16.11 The 1985 audit addressed the public pension programs administered by the federal government - the Old Age Security program and the Canada Pension Plan. This follow-up covers all the major observations and recommendations we made in 1985, as well as the progress of departmental initiatives that were under way then.

Overall Conclusion

16.12 All our observations received serious consideration by the departments and agencies involved. In some areas, there have been significant improvements, but in other areas, progress has been very slow. As in 1985, we are still concerned about the length of time taken to implement improvements.

16.13 Most of the observations relate to the Department of National Health and Welfare. Its management attributes a lack of resources to be the main reason for the delays in improving its benefit delivery systems.

Accountability for Public Pension Management

16.14 Eight federal departments and agencies play important roles in managing public pensions.

16.15 In 1985, we stated that there was significant room for improvement in the accountability for administering the Canada Pension Plan. We recommended that the Department of National Health and Welfare, which has legislated responsibility for liaising and co-ordinating the Plan's activities with other federal departments and the provinces, play a greater leadership role in this area. We also recommended that it help other involved departments establish and implement guidelines for measuring and reporting performance, and regularly review and monitor this information.

16.16 Steering committees composed of representatives from the various departments now meet regularly to review and monitor Canada Pension Plan activities. However, as of May 1987, no agreement had been reached with any department on measuring and reporting performance for the services provided to the Plan. We were informed by Health and Welfare managers that they were waiting for the completion of a comprehensive review of the policy on cost recovery from the Plan (see paragraph 16.55) so that the recommended performance criteria can be incorporated into memoranda of agreement with the participating departments. Thus, the Department was still not in a position of being able to assess how efficiently the Plan's activities were being administered.

16.17 We also recommended that the Department of National Health and Welfare, together with the Department of National Revenue - Taxation, ensure that proper procedures were in place for collecting, recording and transferring accurate and complete Canada Pension Plan contributor information. This was based partly on our observation concerning the numerous errors in the Canada Pension Plan Record of Earnings. This is the permanent record of all contributions and earnings information for each contributor to the Plan. Individual pension benefits are determined by using the information in this system.

16.18 A steering committee composed of representatives from these two departments has been established to co-ordinate the work in this area. An on-line Record of Earnings system, implemented in January 1987, and a program that mails contributor information packages to Plan contributors have helped in correcting some 80,000 suspense items. However, the number of suspense items continues to grow at the same rate as in the early 1980s (see Exhibit 16.1). At the time of our follow-up, there were more than 3.6 million unidentified contributions amounting to $98 million held in suspense. As well, the problems associated with double postings and unrecorded refunds made by the Province of Quebec remain unresolved. The Department of National Health and Welfare informed us that these areas will be addressed as part of the long-term initiative to redesign the system.

16.19 We also said that the role of the Treasury Board in administering the Canada Pension Plan should be strengthened. The Treasury Board Secretariat responded that its role would be reviewed once a comprehensive review of the policy on cost recovery from the Plan was completed. This was to have been finished early in 1986. However, the review was not completed and approved by the interdepartmental steering committee until May 1987. The recommendations of the report are scheduled to be submitted to Treasury Board for consideration in the fall of 1987. Thus the role of the Board has remained unchanged.

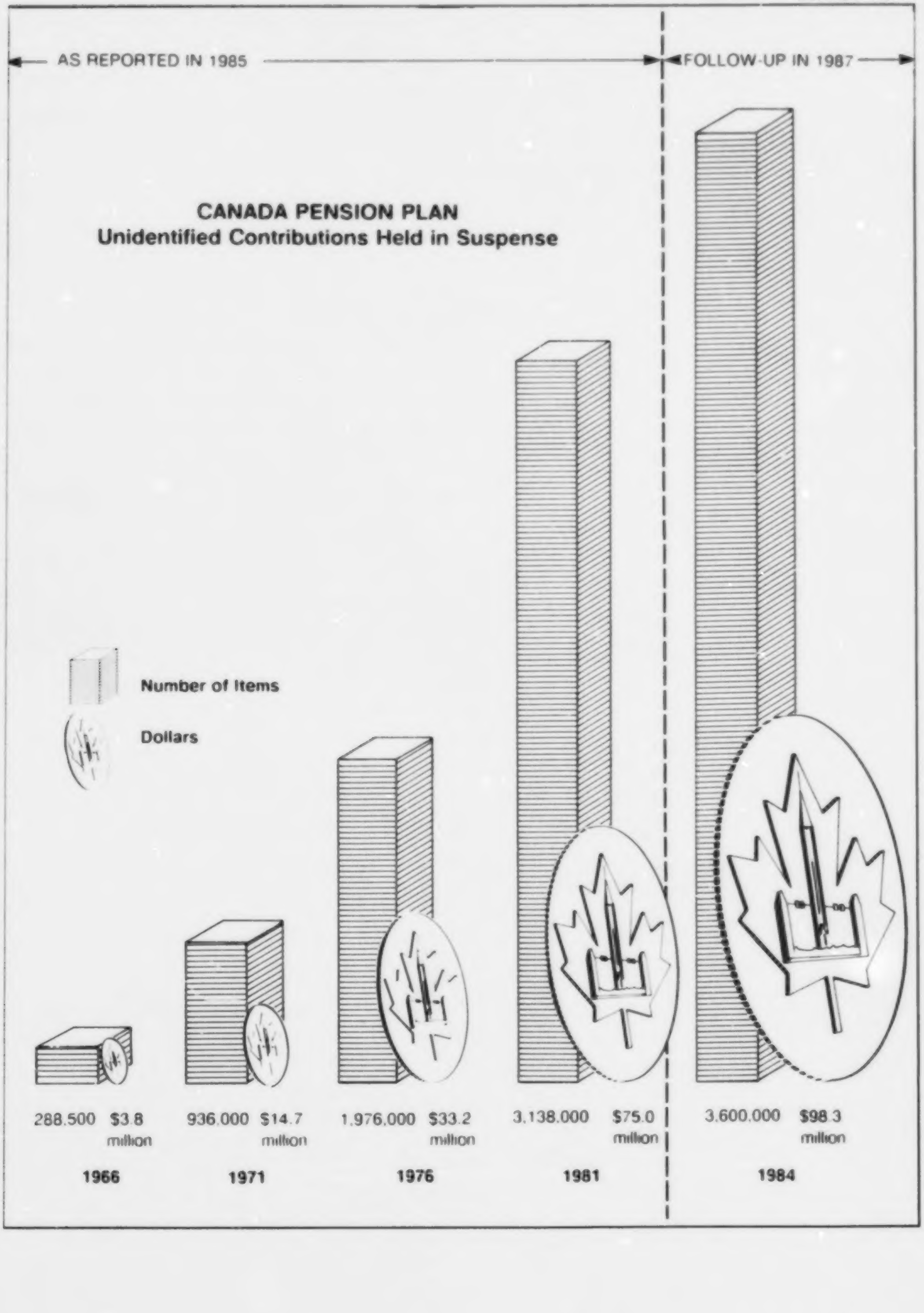
Pension Costs and Commitments

16.20 **Long-term costs and commitments.** In 1985, we expressed concern that Members of Parliament were not receiving adequate information to assess and understand fully both the short- and long-term financial implications of public pension programs. Moreover, despite previous recommendations by parliamentary committees, there was no mechanism for reviewing program costs and commitments regularly.

16.21 In early 1986, the government introduced the Public Pension Reporting Act. This Act requires that long-term pension costs be estimated and reported to Parliament every three years or whenever there is a change in benefits.

16.22 **Forecasting process.** Several departments play essential roles in forecasting the cost of pension programs. In 1985, we found that the lack of an overall policy regarding

Exhibit 16.1


AS REPORTED IN 1985
FOLLOW-UP IN 1987
CANADA PENSION PLAN
Unidentified Contributions Held in Suspense
Number of Items
Dollars
288,500
$3.8 million
1966
936,000
$14.7 million
1971
1,976,000
$33.2 million
1976
3,138,000
$75.0 million
1981
3,600,000
$98.3 million
1984

the costing of these programs had at times resulted in inconsistent cost forecasts of proposed program changes and delays in providing financial information. We recommended that the Office of the Comptroller General, together with the Departments of National Health and Welfare, Finance, and Insurance, establish a co-ordinated process for forecasting public pension costs and ensure accurate, consistent and timely reporting of financial information.

16.23 In responding to the recommendation, the Office of the Comptroller General said that it did not necessarily agree that it should be the focal point for co-ordinating this process. But it agreed to examine this issue together with all the departments concerned. At the time of our review in May 1987, the Office had just begun to act on this recommendation by calling meetings with departmental representatives. The Department of National Health and Welfare was subsequently identified as the focal point for public pension forecasting. However, the roles and responsibilities of the various departments involved, and the operational procedures, have not yet been finalized. The Office estimates that they will be complete before the end of 1987.

16.24 **Reporting to Parliament.** In 1985 we observed that the quality of the information provided to Parliament through the Estimates and annual reports had deteriorated. The result was, in our opinion, that Members of Parliament were getting insufficient information to assess the financial performance of public pension programs.

16.25 In response to our recommendation, the Department of National Health and Welfare has made improvements to its Estimates Part III. It has included tax expenditure information, expanded the explanations for cost variances, and discussed the program take-up rate.

16.26 We also recommended that the Department improve the quality of information in the Canada Pension Plan and Old Age Security annual reports to Parliament and issue them more promptly. Very few changes were made to the 1984-85 annual reports which were tabled in Parliament in October 1986, 18 months after the fiscal year end. At the conclusion of our review, we were provided with the final draft of the 1985-86 annual report approved by the Minister. We noted that a number of major improvements have been introduced. However, as of July 1987, 16 months after the year end, the report had not been tabled in Parliament.

16.27 **Role of senior financial officers.** In 1985, we recommended that senior financial officers in the Department of National Health and Welfare become more actively involved in reviewing financial implications of the public pension programs. Since then, there appears to have been more involvement. However, at the time of our follow-up, the departmental financial function was undergoing a major reorganization.

Benefit Delivery Systems

16.28 In 1985, we reported that the Department of National Health and Welfare placed great emphasis on maintaining a high level of service to the public, and particularly on ensuring that benefit payments are made on time. This continues to be the case in 1987.

16.29 We also reported that although the operational systems and processes that support the benefit delivery systems worked, they were costly, inefficient, limited, outdated and, in some instances, fragile. The need for major system overhauls had first been identified in the mid-1970s, but long-term initiatives were not due to be completed until the 1990s.

16.30 **Improvements to existing systems.** In 1985, we observed a number of areas where we believed the existing systems could be improved, independently of the long-term initiatives – service to the public, performance measurement systems, productivity improvement, detection of fraudulent and unauthorized benefit payments, and the Canada Pension Plan disability operations.

16.31 We were also concerned about what we considered to be unreasonable delays in responding to both external and internal recommendations. Some of these recommendations had been outstanding for as long as eight years.

16.32 *Service to the public.* In 1985, we stated that although a great deal of emphasis had always been placed on providing a high level of service to the public, standards and guidelines for providing this service had not been established. There was also a serious problem for people trying to reach client service centres by telephone.

16.33 In October 1986, the Department carried out a client satisfaction survey and has recently begun using results to develop service guidelines and standards.

16.34 In the Montreal, Toronto, Vancouver, Ottawa and Chatham client service centres, which serve a large percentage of the client population, the Department has introduced sophisticated telephone systems. This action has significantly reduced the number of lost calls in 1986.

16.35 *Performance measurement systems.* In 1985, we reported that the existing performance measurement systems did not adequately measure labour productivity. We also pointed out that it was our fourth assessment of these systems in the last eight years and the fourth time we had expressed concern about their inadequacy.

16.36 Since 1985, the Department has put a great deal of effort into developing a new national system that was implemented in April 1986. The new system has a number of good features. The most important is a system that records productive time used in all major processing activities (except Canada Pension Plan disability operations) and the reporting of output volumes by computers. The Department has also been successful in eliminating regional measurement systems that were producing inconsistent information prior to 1986.

16.37 But, the new system is not yet fully implemented partly due to resource constraints. For example, productivity reporting is still to be computerized. When fully implemented the systems will allow comparisons of performance. It still does not provide an adequate basis for measuring labour productivity. Because of the use of an efficiency index that assumes the base-year efficiency to be 100 per cent, the current system cannot explain adequately whether an efficiency increase is due to productivity improvements, automation, procedural changes, or other factors. In addition, tests have not been done to demonstrate that base-year efficiency levels are reasonable.

16.38 *Delivery processes.* In 1982, we reported that there were significant inconsistencies in delivery processes, and opportunities to improve productivity were being lost. When we examined this issue again in 1985, we found that few significant improvements had been made.

16.39 Some improvements have been made in this area since 1985. For example, the Department has implemented a "Working Smart" program, encouraging employees to suggest better ways of providing client services. Certain savings have been achieved. While the Department has not quantified the amount saved, it told us it plans to do so in the near future.

16.40 *Potential for frauds and unauthorized benefit payments.* In response to audit recommendations and the conclusion of a 1984 internal study that examined the potential for fraud and error in the Income Security systems, the Department set up a Controls Program Unit in 1985 to detect benefit overpayments and develop preventive measures for them.

16.41 Since then, the Unit has carried out a number of reviews of high-risk areas, issued guidelines and procedures for investigating frauds and third party complaints and, in the past year alone, has been responsible for the recovery of $1.6 million in overpayments. But the Unit has been under constant reorganization for the whole time and the director has been changed three times.

16.42 We also reported in 1985, that there had been lengthy delays in addressing internal and external audit recommendations to correct financial and EDP system weaknesses. Little has been done in this area since 1985. Management told us that this was done deliberately in order to avoid over-patching the existing systems which could lead to breakdown in the processing operations. It also feels that the greater emphasis on the detection of benefit overpayments in part offsets these weaknesses. As a result, certain changes that are critical for improving internal controls cannot be introduced.

16.43 *Canada Pension Plan disability operations.* The management of the Canada Pension Plan disability operations was identified as a major problem area in 1985. We found that there were rarely written policies, procedures or directives for conducting key processing operations. There were also indications that performance in critical areas was below a reasonable level. We concluded that the whole situation was unsatisfactory.

16.44 We also pointed out that the Department of National Health and Welfare was giving high priority to this area, and in January 1985 it had begun to take major steps to correct these deficiencies.

16.45 Despite these initiatives, little effective progress has been made since 1985 in correcting many of these problems. A recent internal audit of this activity reached the same conclusion. For example:

- the time taken to process an initial application has only marginally improved, from an average of 90 days to an average of 83 days;
- the percentage of rejected initial applications being appealed remains at 38 per cent;
- only marginal improvement has occurred in time taken to process appeals, which in 1985 were taking from 75 days up to 2 years;
- no action has been taken on recommendations of studies to improve work flow in significant areas; and
- performance measurement data are incomplete and inaccurate, standards do not exist and throughput time measures are not regularly reported.

16.46 Management informed us that the lack of progress was due to recent changes to the Plan legislation, increased workload and difficulties in recruiting qualified staff.

16.47 The Canada Pension Plan disability operations are large. And they are sensitive because of the clientele they serve. Total disability payments were $600 million in 1984-85, $850 million in 1986-87 and will be $1.3 billion in 1987-88. The changes to the Plan that were implemented 1 January 1987 have increased the workload by about 15 per cent.

16.48 We remain very concerned about the management of the disability operations and the lack of significant progress in dealing with the problems – particularly because it was a high priority item for management in 1985.

16.49 **Future plans to improve delivery systems.** In 1985, we reported that the Department was planning a major overhaul of its delivery systems. A general systems design and an organization plan were scheduled to be submitted to Treasury Board in June 1985. Total cost for the project was estimated at $70 million.

16.50 An implementation plan was submitted to Treasury Board in September 1985, with an estimated total cost of $95 million and projected annual savings of $57 million after 1989-90. The plan was considered in conjunction with the Department's 1986-87 Multi-year Operational Plan and was not approved by Treasury Board. A new proposal was submitted in June 1986, seeking $9.7 million to implement short-term projects and to develop detailed long-term plans for integrated processing systems. Treasury Board approved the proposal in principle.

16.51 However, no further work on the development of the long-term plan has been carried out because of lack of availability of funds within the Department. Thus, this important system initiative has been put on hold once again. In 1977 the government first decided to integrate the Canada Pension Plan and Old Age Security Operations to achieve efficiencies in their operations. Ten years and several million dollars later, the government still does not know when this integration will be completed.

Administration Costs

16.52 In 1985, we reported that the Department of National Health and Welfare did not have mechanisms to identify, monitor, control and report administrative costs incurred by it and other departments in running the Old Age Security and Canada Pension Plan programs.

16.53 We pointed out that there were three reasons for this. Existing cost accounting systems did not permit a detailed breakdown of costs. There were no guidelines for the quality and level of administrative service to be provided by the departments involved. And no performance measures had been developed to measure operational efficiency. As of May 1987, there was no change in the situation. This was due in part to the delay in the completion of the study referred to in paragraph 16.56.

16.54 The total costs for administering the Old Age Security program and the Canada Pension Plan in 1984-85 were $65 million and $100 million respectively. In 1986-87, the total costs for Canada Pension Plan were $140 million. The total costs for the Old Age Security program in the same year could not be determined because the Department of Supply and Services had changed the method of reporting its costs.

16.55 Because of the federal-provincial nature of the Canada Pension Plan, we were also concerned in 1985 about the lack of independence in the review and challenge of the Plan's administration costs. We noted that in response to the Department of National Health and Welfare's concerns that there was a strong possibility that the Plan was being overcharged, Treasury Board Secretariat approved in October 1984 the establishment of a task force to carry out a comprehensive, independent review of current policies and practices by departments for charging administrative costs to the Plan.

16.56 The original plan was to complete the review by February 1986. However, it was not completed and accepted by the interdepartmental Steering Committee until May 1987. Subsequently, the Department of National Health and Welfare began to prepare a submission to Treasury Board to amend the present policy and practices. If the recommendations arising from the review are adopted, annual administration costs of the Canada Pension Plan could be lower by between $10 to $16 million (based on the 1984-85 administrative cost calculations).

Public Awareness

16.57 We recommended in 1985 that the Department of National Health and Welfare introduce better public disclosure and education programs for all federal public pensions and their role in the retirement income system. The Department supported our recommendation and began a number of initiatives in addition to those it already had under way.

16.58 The Department told us that these initiatives have now been shelved because of lack of funds.

Mixed and Joint Enterprises - 1985, Chapter 5

Introduction

16.59 In 1985, we commented on the extent and quality of information available to Parliament on mixed and joint enterprises. Mixed and joint enterprises are share capital corporations in which the federal government has a direct equity position together with private sector participants or with other governments in order to further common objectives.

16.60 Our review showed that financial and other information available to Parliament about such enterprises was fragmented and incomplete. We concluded that there was both a need and an opportunity to improve the flow of information to Parliament on the nature, extent and result of government's involvement in mixed and joint enterprises.

16.61 We recommended that the government improve the quantity and quality of information available to Parliament on the purpose, nature and extent of the government's participation in mixed and joint enterprises, as well as the government's expenditures on, and the ongoing operations, financial position and results of such corporations.

16.62 In our review of developments since 1985, we considered the information now available to Parliament and interviewed staff of the House of Commons, the Crown Corporations Directorate of Treasury Board/Finance, and the Office of the Comptroller General.

Findings

16.63 The quantity and quality of information on the purpose, nature and extent of the federal government's participation in mixed and joint enterprises have improved since 1985. However, improvements are still possible.

16.64 **The Public Accounts.** These serve as the primary vehicle for providing information to Parliament on mixed and joint enterprises. Information on these enterprises is found primarily in Volumes I and III.

16.65 Improvements made to Volume III of the Public Accounts in respect to mixed and joint enterprises address most of the recommendations we advanced in our 1985 chapter. Similarly, a new part of the Loans Investments and Advances section of Volume I, entitled Mixed and Joint Enterprises, provides more comprehensive information on the loans, investments and advances related to such entities, in both tabular and narrative form, than was previously available. However, in 1985-86, Volume I included such information for only 9 of the 14 corporations (excluding those in which shares were held by the Superintendent of Bankruptcy) described as mixed and joint enterprises in Volume III.

16.66 **The Estimates.** In 1985 we concluded that practices at that time were satisfactory in light of the small numbers involved and the low materiality of mixed and joint enterprise transactions that had gone through the Estimates in recent years. This state of affairs has not changed, nor has our assessment.

16.67 **Reporting policy on mixed and joint enterprise corporations.** The Treasury Board Secretariat is in the process of developing policy respecting the accountability of such corporations, including their reporting relationship to Parliament and to Treasury Board Ministers.

Conclusion

16.68 The quantity and quality of information on mixed and joint enterprises have improved since our 1985 chapter, and efforts to implement further improvements are going on. These developments are appropriate given the present materiality of mixed and joint enterprises. However, it might be necessary to reassess the situation should the privatization process or other action yield large mixed or joint enterprise corporations outside the coverage of Part XII of the Financial Administration Act.

Atomic Energy Control Board - 1985, Chapter 8

16.69 In our 1985 audit of the Atomic Energy Control Board, we made two recommendations. The first was that the Board develop criteria and analysis that are appropriate for determining the need for socio-economic impact studies in each sector of the atomic energy industry that it regulates. The second was that it should establish procedures to ensure that cyclical evaluation of the effectiveness of its programs is carried out and that the results are appropriately reported.

16.70 In following up these recommendations, we reviewed internal documents including an action plan and progress reports. We also interviewed Atomic Energy Control Board and Office of Privatization and Regulatory Affairs personnel. We found that the Board has made progress in implementing both recommendations.

Socio-economic Impact Analysis

16.71 At the time of our audit, it was government policy that major new regulations relating to health, safety or fairness be subjected to a socio-economic impact analysis. The Atomic Energy Control Board had decided, and Treasury Board had concurred, that the regulations, then under revision, to govern radium and thorium mining did not fit into the category of major regulations, primarily because the cost of implementing them would not exceed $10 million in a year.

16.72 As of September 1986, the government introduced a new regulatory action plan that requires the preparation of regulatory impact analysis statements for all proposed regulations and amendments. The Board is in the process of complying with this new policy, and this appears to address our previous concerns.

Effectiveness Evaluation

16.73 During our 1985 audit, we found that the Atomic Energy Control Board had yet to complete an evaluation of any of its activities, although a review of the Nuclear Liability Act was under way at the time. The Board had produced a program evaluation plan but it was incomplete. The Board undertook to develop the plan further and to implement it.

16.74 Despite resource constraints, the Atomic Energy Control Board has made significant progress. The review of the Nuclear Liability Act is nearing completion. The Board has almost finished an evaluation of its Research Program and has completed an assessment for evaluating its Canadian Safeguards Support Program. Although this initial evaluation work has covered relatively small organizational units, the Board is developing a revised evaluation plan for the fall of 1987. The plan will cover the remainder of the Board's program components in a way designed to facilitate executive decision making.

16.75 The Atomic Energy Control Board has responded positively to our recommendation. We plan to follow up again once the results of planned evaluations are available.

Department of the Environment - Atmospheric Environment Service - 1985, Chapter 9

Introduction

16.76 Our 1985 comprehensive audit of the Atmospheric Environment Service, a sub-entity of the Department of the Environment, concentrated on the activity that produces weather forecasts for the majority of the land masses of Canada, relevant airspaces, and important sea areas.

16.77 We identified weaknesses in two types of activities. One related to weather forecasting as a public service that overlaps the interests of other departments and the private sector. The other related to the process that produces the weather forecasts.

Findings

16.78 In the area of weather forecasting as a public service, the Service has reacted positively to our recommendations. It is now better able to provide assurances that the service is concentrating on its priorities and is avoiding the risk that it is inhibiting the growth of the private meteorological sector in Canada; that it is recovering all costs of services that should not be borne by the public purse; and that the broadcast media have improved the accuracy of their weather forecast information.

16.79 Three of the four recommendations for improving the management of the process that produces the weather forecasts were relevant to our follow-up work. The remaining recommendation applied to financial commitments for computer services scheduled to be made after June 1990.

16.80 Our follow-up work indicated that progress has been made in the activities we identified in 1985. But more needs to be done. The Atmospheric Environment Service is not yet able to give adequate assurance that expenditures on the individual inputs into the weather forecast production process (forecaster skills, work station environment for the forecasters, numerical weather prediction guidance, weather observations, radar echoes, satellite imagery and communications) are cost effective. Our 1985 audit work indicated that the Service did not know whether it was spending too much or too little on these inputs.

Conclusion

16.81 Generally, the Atmospheric Environment Service has responded positively to the spirit of the recommendations made in our 1985 report. In some areas the needed management improvement has been achieved. But in others, further progress of the initiated improvement will have to be made to deal adequately with the identified weaknesses.

Department of Regional Industrial Expansion - 1985, Chapter 12

16.82 Our 1985 audit addressed DRIE's delivery of direct assistance programs. We also examined internal audit and program evaluation and the role played by corporate sector branches in reviewing project proposals.

16.83 In our follow-up to the 1985 audit we concentrated on DRIE's three largest direct assistance programs: Industrial and Regional Development Program (IRDP); Defence Industry Productivity Program (DIPP); and Economic and Regional Development Agreements (ERDAs). These accounted for $611 million or 70 per cent of DRIE's total expenditures on grants and contributions in 1986-87.

16.84 In an April 1986 letter to the Public Accounts Committee, DRIE indicated that action had been taken on all recommendations from our 1985 chapter. In our follow-up, we examined the actions taken by DRIE in response to our previous observations and recommendations. We also reviewed a sample of projects approved after 1 June 1985 to determine whether these actions were being carried out at the individual project level. We use examples here in reporting our findings. These are not intended as a complete list of all projects to which our observations apply; they are only illustrations of some of the instances we noted.

16.85 On 6 June 1987, the government announced the establishment of the Atlantic Canada Opportunities Agency. The Agency was given responsibility for most of DRIE's regional economic development programs in Atlantic Canada. Also, on 4 August 1987, the Western Diversification Office was established. This office will operate a number of DRIE programs in Western Canada. Although responsibility for managing these programs has been shifted, the programs were unchanged at the time we concluded our follow-up. We believe that our observations with respect to the Industrial and Regional Development Program and subsidiary agreements are relevant in the new organizational structure.

Industrial and Regional Development Program

16.86 Under the Industrial and Regional Development Program (IRDP), DRIE can provide direct assistance to manufacturing, processing and designated service industries in all parts of Canada. This assistance is usually provided by means of grants, contributions and repayable contributions.

16.87 The Department has addressed the observations and recommendations in our 1985 Report Action has been taken on all recommendations and improvements were evident in several areas. However, a number of the program delivery practices we criticized in 1985 were still present.

Policy Direction

16.88 The Department has strengthened procedures for developing policy and providing advice on program delivery. A Program Policy Committee, with representatives from headquarters and all regions, has met regularly to review and resolve policy or procedural issues. Decisions taken by this Committee have been communicated systematically to staff involved in program delivery.

Project Selection and Approval

16.89 The Industrial and Regional Development Act requires that no DRIE assistance be provided if it is probable that a project will proceed without assistance in the same location, scope and timing. It also requires that a project must make a significant contribution to the economic or social benefit of Canada. Regulations and internal directives elaborate on these criteria and establish others regarding project selection. If these criteria are applied, they help the Department achieve its objectives and provide value for the taxpayers' money.

16.90 Our audit focused on projects that were approved. These are the minority of projects assessed by DRIE. In 1986-87 DRIE received 2,031 requests for assistance under the Industrial and Regional Development Program (IRDP). In the same period, the Department entered into 850 contracts for assistance. One reason that many were rejected was DRIE's assessment that they did not meet the tests of need for assistance and significant contribution to the economic or social benefit of Canada, or other DRIE requirements. Nonetheless, the 850 projects approved were significant, representing commitments of $206.6 million, in addition to the costs of administering the program.

16.91 In our follow-up, we examined 113 of the 1,185 projects approved between 1 June 1985 and 31 October 1986. These represented about 10 per cent of the number of projects and 41 per cent of the dollar value of approvals in that period.

16.92 Assessing a project against the criteria of need for DRIE assistance and significant economic or social benefit to Canada is the most critical and difficult part of the review and approval process. In our 1985 audit, we placed considerable emphasis on examining how issues relating to eligibility were addressed before projects were approved.

16.93 In 1985 we observed a number of projects where questions of eligibility were not adequately addressed before approval. This continues to be a problem. We had a similar observation on project selection for 14 of the 113 approved projects in our current follow-up sample. Documentation on file indicated that the funding of these projects appeared to be inconsistent with the Act, Regulations or Internal policy. If there were other factors on which the decisions were based, these were not documented.

16.94 For example, in December 1983, DRIE received an application for a $20 million contribution to support a project in Alberta involving the expansion of an amusement park, and construction of a marine attraction and water theme park to create a major tourist attraction at a shopping mall. Review by DRIE staff indicated that the project would proceed without federal funding. This made the project ineligible for funding. DRIE also noted that construction had begun in summer 1984. The project was reviewed in March 1985 by the DRIE Internal Board which recommended against support under IRDP.

16.95 In July 1985 Cabinet reviewed the project and directed that federal funds be restricted to the Canada-Alberta Tourism Agreement. This agreement had been signed in May 1985 and provided for a maximum of $5 million per project. Funding under this agreement would have required provincial support which was not given in this case.

16.96 In August 1985, notwithstanding the Cabinet decision, the DRIE Minister offered the company a $5 million contribution under IRDP. The offer was accepted. In December 1985, DRIE staff indicated that the Cabinet decision had to be altered to permit the use of IRDP as the funding mechanism. In July 1986 the acting DRIE Minister obtained Cabinet approval for the $5 million contribution. In August 1986, $4.5 million was paid. Other documentation indicated that as late as September 1986, DRIE was still unwilling to acknowledge that a commitment had been made to the company. When the IRDP report for 1985-86 was tabled in Parliament in December 1986, this contribution was included.

16.97 In our follow-up sample there were several projects involving applicants who appeared to have the resources necessary to carry out the proposed projects. For these projects, documentation focused on the benefits of the project, rather than on why the company required public funding to proceed with it.

Statements of Economic or Social Benefits

16.98 In December 1985, the Department revised its Project Summary form to improve its coverage of items such as the rationale for Crown support and the statement of economic benefits to the region and to Canada. In our follow-up, we concluded that the assessments of expected benefits generally appeared to be more realistic, although in several projects there was limited documentation in support of the stated benefits. We noted several projects where "jobs maintained" were indicated as an expected benefit, but where there was no indication that the jobs were at risk or in jeopardy had the project not taken place.

16.99 The revised Project Summary form and instructions to project officers do not provide any further guidelines on how to assess whether a project meets the statutory requirement of "significant contribution to the economic or social benefit of Canada". DRIE has consistently taken the position that this requirement cannot be defined further, and that each case must be reviewed independently rather than against some previously established guidelines or standards. The need for a high level of professional skill and judgement in assessing projects is evident. However, in our opinion, where program legislation is so broadly worded, particularly for a program that involves direct grants or contributions to third parties without scrutiny by Parliament, it is reasonable to require that those administering the program establish more specific selection guidelines. This would still leave considerable room for professional judgement, and would help ensure that projects that are supported provide the greatest value for the taxpayers' money.

Repayable Contributions

16.100 DRIE issued a guideline on repayable contributions on 28 May 1986. It required that contributions should normally not be repayable for projects involving DRIE assistance of $500,000 or less. Roughly 92% of projects fell into this category. The threshold had previously been $100,000. The intent was to reduce collection costs while ensuring that the bulk of funds were subject to repayment. However, there was no requirement that the rationale for recommending a non-repayable contribution be documented. We noted 10 projects greater than $500,000 were it would have been appropriate to consider a repayable contribution but where there was no indication that this was done.

Management Information Systems

16.101 The Department reacted promptly to our 1985 observations on the number of data errors in the major IRDP information system. In our follow-up, we noted that the accuracy of the data elements we reviewed on the projects in our sample was much improved. However, because the projects in our sample were recently approved, we were unable to assess the quality of information on forecast cash flows, nor did we examine the accuracy of information on projects approved to June 1985.

Future of IRDP

16.102 The Industrial and Regional Development Act will expire 30 June 1988. At the time we ended our follow-up, different options were being considered for a possible successor program. We recognize that if a successor program is introduced, it will likely be substantially different from IRDP and, as a result, some of our observations may no longer apply. However, basic criteria such as the need for public funding for a project to proceed and establishing what benefits are expected to result from public funding should continue to be present in any program of direct grants or contributions. These should be addressed early in the design of any successor program.

Defence Industry Productivity Program

16.103 Under the Defence Industry Productivity Program (DIPP) contributions are provided to companies in defence-related industries for research and development, establishing Canadian companies as qualified suppliers, modernizing facilities and carrying out market feasibility studies.

16.104 In September 1986 the Treasury Board approved revised terms and conditions governing the administration of DIPP. Implementing these should address most of the concerns we raised in our 1985 audit.

Project Assessment

16.105 DRIE incorporated the new terms and conditions into program guidelines that were issued in November 1986. These guidelines describe the criteria for project evaluation and for assessment of the need for assistance. In our follow-up we observed that the assessment of all criteria was not being systematically documented for each project. Because there was no rationale on file for excluding certain criteria, we could not tell if particular criteria had been overlooked or did not apply.

Monitoring

16.106 Project benefits are to be monitored following payment of the final claim. However, our review of project files and discussion with program personnel indicate that a review of project benefits often does not take place and is not considered a high priority. This is consistent with previous comments that monitoring, although DRIE acknowledges it as very useful, is not done because of staff limitations. However, the Department has recently taken steps that indicate it will place greater emphasis on monitoring project benefits.

Repayment of Crown Assistance

16.107 The standard DIPP repayment clause has been modified to establish repayment conditions that are more specific. These are now usually based on a percentage of future sales, royalty on each item sold, or a fixed repayment date. This addresses the problem we noted in 1985.

16.108 Most current projects are based on older contracts that include the former "fair and reasonable" clause. These projects are being examined on a case-by-case basis to establish an appropriate level of repayment.

Audit of DIPP Projects

16.109 In December 1986 DRIE finalized an audit policy that requires assessing the need for audit against the size of the project, history and risk. This will ensure that high cost and high risk projects will be audited. A statistical sample of lower risk projects will also be audited. This is an appropriate approach.

Economic and Regional Development Agreements

16.110 Economic and Regional Development Agreements (ERDAs) provide a broad framework of general economic development objectives for each province. Specific subsidiary agreements under the ERDAs are the means by which projects are authorized and financial commitments made. Once signed, subsidiary agreements are jointly managed by DRIE regional offices and representatives of the provinces.

16.111 In 1985 we observed that the original amount of money identified in a subsidiary agreement frequently appeared to become an expenditure target. We commented that there was little information or monitoring in headquarters of projects approved, and we reported several instances where projects were approved that did not appear to be consistent with objectives or eligibility criteria. This seemed to occur more frequently in subsidiary agreements designed to cover specific geographical areas, but it also happened with other types of agreements.

16.112 The same findings applied to our 1987 follow-up. We examined 61 of 327 projects under 12 agreements. These represented about 19 per cent of the number of projects and 32 per cent of the $144.2 million of approvals recorded in the period covered. In the sample of agreements we examined, we saw similar instances of inconsistency with objectives, incomplete information for decision making, non-compliance with program authorities, and other administrative problems. Following are some cases that illustrate our findings.

Canada-Newfoundland Tourism Development Agreement-Tourism Travel Generators Program

16.113 As described in the agreement this program is "to develop new, or consolidate existing travel generators to provide the critical mass necessary to create development that will encourage private sector investment".

16.114 We observed two projects involving $350,000 in DRIE expenditures where the applications were made and the contributions received in the name of a non-profit organization. However, in substance, Parks Canada was the applicant, not the non-profit organization. It was Parks Canada that put the applications forward. These projects, which involved restoring a military barracks at Signal Hill and constructing a Viking Ship at l'Anse-au-Meadows, were on sites owned by Parks Canada.

16.115 Parks Canada was correctly identified in one document as the owner of the Signal Hill building, and was to be responsible for its operation and maintenance. In the case of the Viking Ship, Parks Canada was initially identified as the applicant, along with the Provincial Department of Development and Tourism. However, the official record shows the non-profit organization as the applicant. Project documentation sent to the DRIE Tourism Minister for the Viking Ship referred only to the non-profit organization and did not point out the connection to Parks Canada. In our view, the identification of a third party as the applicant gave a misleading picture of the proposed recipient of DRIE funds.

Canada-Newfoundland Tourism Development Agreement-Tourism Incentives Program

16.116 Under this agreement, a contribution of $600,000 (DRIE share $300,000) was approved for renovations to a hotel's rooms and convention facility. A condition of the contribution was that the renovated convention facility should not exceed a maximum capacity of 300 delegates instead of the capacity of 600 originally sought by the applicant. DRIE rejected the larger facility because it would then be competing with a convention facility DRIE had supported elsewhere in Newfoundland. During our follow-up we noted that the hotel was advertising a delegate capacity of up to 750. DRIE was not aware of this although it had carried out an on-site inspection. We believe that when special conditions are attached to a project, DRIE should, as a minimum, monitor the project to ensure that they are respected.

Canada-Nova Scotia Strait of Canso Area Development Subsidiary Agreement

16.117 This agreement, signed in 1984, involves total planned expenditures of $28 million. We examined the Small Project Assistance Program involving planned DRIE expenditures of $8.4 million. The objective of this program is to "provide funds for small-scale industrial infrastructure elements to support future development opportunities in the Strait of Canso Area." The agreement also specified that the Province would "directly or through its agencies (including municipalities) assume ownership of each capital project."

16.118 **Port Hawkesbury Airport.** DRIE approved a $1.3 million contribution (DRIE share $903,700) to purchase and install a microwave landing system at this airport. We were advised that the project was approved to support manufacturing jobs at a company in Sydney, Nova Scotia. There was no indication that there would be any employment benefits in the Strait of Canso Area from this project. Transport Canada had indicated that there was no user demand for that installation because there were no aircraft in the Atlantic Region with compatible microwave landing system equipment. We found no indication that this concern had been addressed prior to project approval.

16.119 We also noted that some of the operating costs of the airport were being funded by the subsidiary agreement. This was contrary to an explicit condition under which the subsidiary agreement was approved.

16.120 **Port Hawkesbury Industrial Building.** A total of $1.1 million (DRIE share $762,300) was approved for construction of an industrial building. This was not consistent with the type of infrastructure projects described in the agreement. The agreement referred to "firm specific infrastructure" such as a new wharf, drydock or site services. We noted that "Infrastructure" was defined in another DRIE program to include roads, sewers and water treatment plants, not industrial buildings.

16.121 Ownership of the building was given to the Port Hawkesbury Industrial Commission with the intention that any revenue above operating costs generated from the building would be re-invested in other projects in the industrial park. This is contrary to the requirement that funding of administrative and operating costs be limited to those of the Strait of Canso Industrial Development Authority. In effect this resulted in a circumvention of the agreement by establishing a capital base to subsidize the Commission's ongoing programs.

Canada-Quebec Industrial Development Subsidiary Agreement

16.122 This agreement, signed in 1985, involves total planned expenditures of $350 million (DRIE share $175 million). At the time of our follow-up, approved projects totalling $82.2 million in DRIE expenditures had not been entered into the main management information system for subsidiary agreements.

16.123 In one project, the Minister had signed a memorandum of agreement for a federal contribution of $55 million to assist in financing a new automobile plant. DRIE's commitment had been publicly announced. However, this commitment was not included in the financial information system.

16.124 The information system was designed to ensure that commitments are recorded once projects are approved by the appropriate delegated authority. We were informed that in this region the practice was to not enter an amount into the system until a signed contribution arrangement was returned to the Department by the recipient. In our view, the effectiveness of a Department-wide information system is compromised unless all regions enter information consistently. We advised DRIE regional management in January 1987 that several projects were not included in the information system. At the end of our audit, these commitments had been entered into the information system.

16.125 Another project involved a letter of intent indicating that funding of up to $45 million (DRIE share $22.5 million) could be available if a company met certain conditions. The DRIE region advised us it did not consider this as a commitment, and therefore it did not have to be recorded as such. However, we were also advised that one of the purposes of this letter of intent was to assist the applicant in developing a financing plan for the project. Although it may claim that this or similar letters are not commitments, and even though these documents may contain a disclaimer, the government's intent and commitment to such projects are evident. Failure to record these as conditionally approved projects with financial commitments means DRIE forecasts of future commitments may be understated.

Canada-Quebec Tourism Subsidiary Agreement

16.126 This agreement, signed in 1985, involves total planned expenditures of $100 million (DRIE share $50 million). We examined projects under the Market Development Program which had objectives related to the promotion of tourism products.

16.127 In October 1985, an applicant requested funding for the Alpine World Cup Ski Finals at Bromont, Quebec, in March 1986. A budget of $1,178,000 was prepared, of which $100,000 could clearly be identified as marketing costs. The remainder was for technical and administrative items (race preparation, racing centre, electronic score board, building). The Minister approved a federal contribution of $300,000. DRIE's rationale for supporting this contribution was that it would enable Bromont to become a yearly stop-over for one of the

World Cup competitions. However, no site in Canada has been designated as a permanent site for World Cup Ski events. No World Cup race was held in Bromont in 1987, nor is any planned for 1988. The maximum contribution allowable under this program for the marketing portion would have been $75,000 of which the DRIE share would normally have been $37,500.

Winnipeg Core Area Subsidiary Agreement

16.128 A first agreement, signed in 1981, involved total planned shareable costs of $96 million for this agreement. Expenditures under this agreement are to be shared equally among Canada, the Province and the City of Winnipeg.

16.129 The agreement stated that no projects may be authorized after 31 March 1986. This is a standard clause in subsidiary agreements. In our opinion the wording of the agreement established clearly the intent to terminate the approval process after 31 March 1986 in order to start the wind up of the agreement. At 31 March 1986, $6.3 million remained uncommitted. However $4.5 million was committed under the agreement between 1 April 1986 and 30 September 1986. We were informed that the region considered these funds to have been committed prior to 31 March 1986, because it had previously made an allocation of uncommitted funds under the agreement.

16.130 This was a general allocation, and contributions to specific recipients had not always been approved. In our opinion, these individual contributions were projects; those where specific approval was not authorized before 31 March 1986 should not have been approved after that date.

16.131 The agreement also states that any revenue from sales of land after 31 March 1986 cannot be used to reduce shareable costs and that revenues are shareable among the three parties unless determined to be non-shareable by the Agreement Management Board. In our view, this goes beyond the authority that can be given to a department. The Financial Administration Act establishes that public money must be deposited to the Consolidated Revenue Fund. In our view, if such revenues are generated DRIE must ensure that the federal share does flow back to the Consolidated Revenue Fund.

Tourism Subsidiary Agreements

16.132 Tourism subsidiary agreements contained objectives or selection criteria to the effect that projects should involve the development of nationally and internationally competitive and high quality tourism destinations to be eligible for public funding. However, the application of these criteria was a problem for DRIE. We observed several approved projects that appeared primarily to serve a local rather than a national or international market.

Conclusion: Subsidiary Agreements

16.133 The nature of subsidiary agreements requires that they be developed to respond to different regional needs and managed with appropriate regional decision making authority.

However, this extensive delegation of authority, coupled with the absence of headquarters review, increases the need for discipline by DRIE to ensure that projects being funded are consistent with the subsidiary agreements. In our view, this discipline was not always present. As in 1985, we were advised that DRIE often agrees to fund a project because of pressure from provincial representatives.

16.134 Regional development should not be equated with regional spending. Funds identified for possible expenditure under subsidiary agreements are not intended to be automatic transfer payments to the provinces or third parties. Although responsibility for managing these agreements is shared with the provinces, DRIE - or a successor agency - must be accountable for its expenditures and, in our view, should be prepared to take a firmer stand on carrying out its part in managing these agreements.

16.135 Approved objectives and authorities provide a framework for accountability and control, and should be respected in program delivery. If officials believe that the approved objectives or authorities for an agreement are no longer valid or appropriate, they should have them reviewed and revised if necessary. They should not ignore them. Program objectives or authorities should not be disregarded because of a desire to be seen to be responsive to other levels of government or because there is little review of approved projects by headquarters.

Internal Audit and Program Evaluation

16.136 In April 1986, the Internal Audit Branch and the Program Evaluation Branch were combined in a Program Review Branch. In October 1986 they were split again, and the Program Evaluation function was transferred to the Policy Branch. The Review Branch was re-named the Operations Audit Branch and was assigned a quality assurance function as well as responsibility for internal audit. The mandate of this Branch was being finalized at the time we ended our follow-up. Because of the impact of these organizational and mandate changes, we decided it would be more appropriate to examine the audit and quality assurance functions in our future work.

16.137 In the case of program evaluation, we limited our work to a general review of actions taken by the Evaluation Branch in response to our 1985 observations. We concluded that there is still a need to improve the process for preparing the overall DRIE evaluation plan and to ensure that the Branch reviews completed evaluations.

MANAGEMENT CATEGORY

MANAGEMENT CATEGORY

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17

MANAGEMENT CATEGORY

Introduction

17.1 The 4,300 members of the Management Category at the Executive (EX) and the Senior Management (SM) levels are responsible for managing a wide variety of government programs in more than 65 departments and agencies and/or for giving advice to deputy ministers and, through them, to ministers concerning these programs. Management Category members are also expected to provide leadership and direction to more than 217,000 public servants. In addition, they are primarily responsible for administering the federal government's budget of more than $100 billion.

17.2 The management of senior personnel in the public service has been the subject of a number of reports and studies over the past 25 years. Among others, the Glassco Royal Commission on Government Organization (1962), the Finkelman Report on Employer-Employee Relations in the Public Service of Canada (1974), the Lambert Royal Commission on Financial Management and Accountability (1979) and the D'Avignon Special Committee Report on the Review of Personnel Management and the Merit Principle (1979) expressed a number of concerns including:

- the lack of a sufficient and identifiable managerial cadre;
- the need for deputy heads to have more authority and flexibility in managing their senior human resources in a manner that permits accounting for the use of that authority; and
- the lack of attention given to human resource management and the lack of appropriate human resource policies for senior personnel.

17.3 In response to these and other concerns, the President of the Treasury Board announced plans in July 1980 to establish a Management Category as the foundation for improving management in the public service. The main objectives were to:

- increase the managers' sense of identity and reinforce the concept of management;
- provide greater flexibility to deputy ministers to deploy and develop their management teams, thereby fostering the optimum use and development of managerial resources in a manner that would permit accounting by deputy heads for their actions;
- provide a common and uniform conceptual approach to job evaluation and compensation for managers, designed to discriminate between high and low achievers, thereby encouraging managers to maximize their efficiency and effectiveness;
- implement more rigorous selection and promotion practices; and

- improve human resource and career planning and establish a training program for managers.

New and improved management information systems would support the achievement of these objectives.

17.4 Extensive communication activities were carried out by the Treasury Board Secretariat and the Public Service Commission to inform prospective members of the Management Category of these initiatives. The creation and management of the Management Category took place in an environment characterized by budgetary restraint and increased government control over the size of the public service.

17.5 It has been almost seven years since the decision by Cabinet to establish the Management Category. Given that the effectiveness and efficiency of the public service are significantly influenced by this group, we examined some of the key Management Category human resource management programs, systems and practices to determine the extent to which Management Category objectives set by the government in 1980 have been achieved and whether these programs, systems and practices reflect value for money.

Audit Scope and Methodology

17.6 Our audit examined policies, programs and practices related to Executives and Senior Management. This included the management of organization change, job evaluation, compensation, resourcing and related practices (human resource planning, staffing, training, career development, and counselling). The audit also addressed the management of Executive and Senior Management performance and the adequacy of controls over the number of senior personnel. Human resource management practices related to Governor in Council appointees were excluded from the scope of the audit.

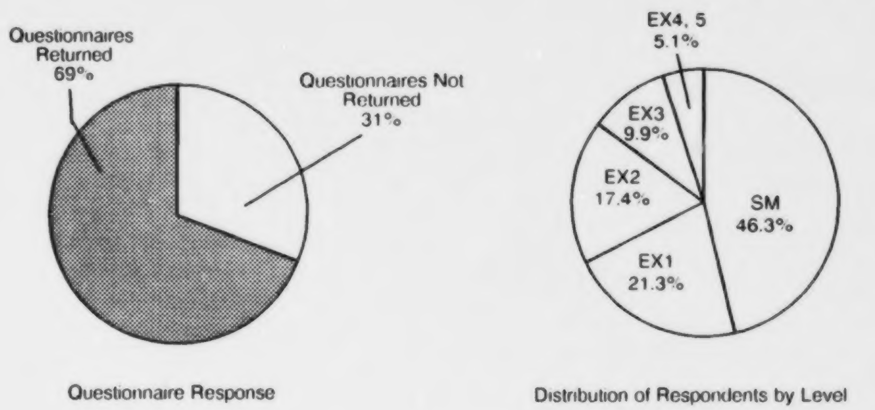
17.7 We conducted a survey of public and private organizations to review and discuss their human resource policies and practices for management personnel. The results contributed to our definition of acceptable human resource management practices for senior personnel.

17.8 We reviewed the legislative and administrative framework pertaining to the Management Category. We also reviewed the Treasury Board Secretariat and Public Service Commission policies, programs and systems concerning the Management Category. Finally, we examined the way in which six departments administer these policies and programs.

17.9 Our audit methodology included a review of relevant documentation, case studies, and interviews with a representative sample of Executives and Senior Management in the six departments. We also interviewed 13 deputy heads or equivalents and a number of former public servants knowledgeable about Management Category programs.

Exhibit 17.1

SURVEY OF EXECUTIVES (EXs) AND SENIOR MANAGEMENT (SMs) REGARDING KEY MANAGEMENT CATEGORY HUMAN RESOURCE PRACTICES



17.10 We developed audit criteria that were reviewed and agreed to by central agencies at the outset of the audit examination phase.

17.11 We distributed a questionnaire to all members of the Management Category to obtain information on their involvement in and perceptions about Management Category human resource programs and practices covered by the audit. Sixty-nine per cent of Category members returned their questionnaires, as shown in Exhibit 17.1. The information acquired from them was used to corroborate audit findings resulting from our examination in the six departments and the central agencies.

17.12 To detect possible bias in survey results, we conducted a follow-up telephone interview survey of 267 Executives and Senior Management chosen at random. This enabled us to ascertain that non-respondents would not have affected survey results significantly had they completed the questionnaire. Because of different human resource practices, respondents from the Department of External Affairs are excluded from statistics used in this chapter.

17.13 Only the most significant audit results are presented in this chapter. A detailed presentation of all our findings and observations has been made to those in the central agencies directly responsible for Management Category human resource programs, policies and practices.

Legislative and Administrative Framework

17.14 Under the terms of the Financial Administration Act, Treasury Board is the employer and is responsible for human resource management in the public service, subject to direction from Cabinet. This includes determining human resource requirements, pay, employee benefits, hours of work, training and development, classifying positions and employees, and providing awards for outstanding performance. Appointments to and within the public service are the responsibility of the Public Service Commission.

17.15 Treasury Board Secretariat assists Treasury Board in establishing the objectives, policies and procedures relative to human resource management for the Management Category and other senior personnel.

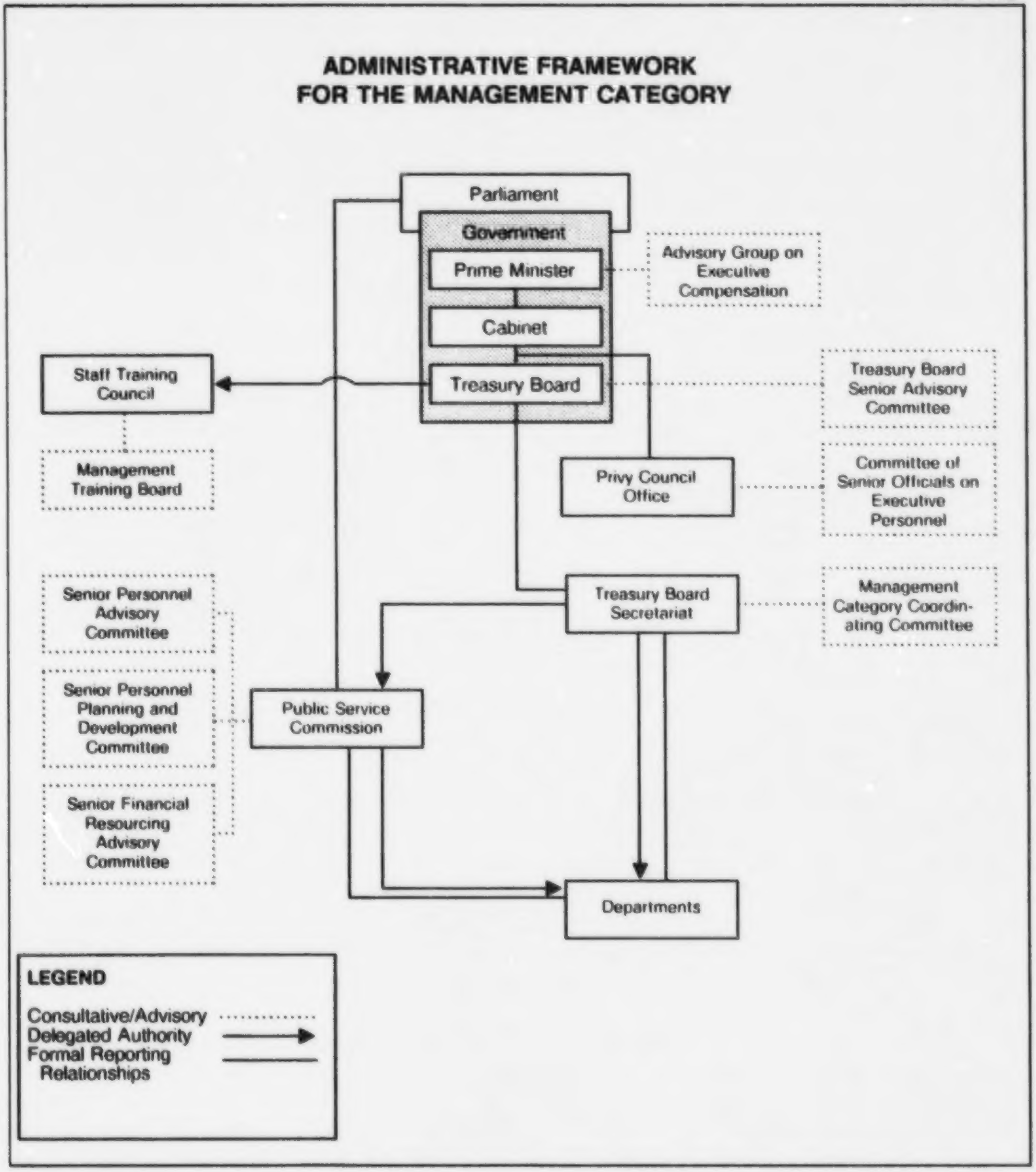
17.16 The Public Service Commission is accountable to Parliament for the application of the merit principle and related functions such as conducting appeals and certain types of investigations. It gives direction to departments concerning appointments made under delegated authority and supports departmental human resource planning. In making or providing for appointments, the Public Service Commission is expected to take into account the managerial objectives and policies of the Treasury Board and the overall governmental direction provided by Cabinet. Under authority delegated by the Treasury Board, the Commission carries out management orientation and other training as well as developmental programs for managers, including the Career Assignment Program (CAP) and the Interchange Canada program. In addition the Commission provides support to departmental affirmative action programs.

17.17 Deputy heads, through a system of delegated authority from Treasury Board, have the primary responsibility for Management Category human resource and succession planning, training, development, performance review and employee appraisal, and counselling. Departments are also responsible for implementing and administering other Treasury Board policies and programs such as compensation, pay for performance, affirmative action and conditions of employment for Management Category personnel. Deputy heads do not have delegated authority for classifying Management Category positions at any level. However, they have the delegated authority to organize their departments up to and including the Executive 3 level.

17.18 Through delegation from the Public Service Commission, deputy heads have the authority to deploy members of the Management Category in their department, as long as the level of the employee does not change. All other appointments for the Management Category are carried out by the Public Service Commission.

17.19 In support of their responsibilities for the Management Category, the government and the central agencies seek advice and support from a number of co-ordinating and consultative bodies (see Exhibit 17.2).

Exhibit 17.2


ADMINISTRATIVE FRAMEWORK
FOR THE MANAGEMENT CATEGORY
Parliament
Government
Prime Minister
Cabinet
Treasury Board
Advisory Group on Executive Compensation
Treasury Board Senior Advisory Committee
Staff Training Council
Management Training Board
Privy Council Office
Committee of Senior Officials on Executive Personnel
Treasury Board Secretariat
Management Category Coordinating Committee
Senior Personnel Advisory Committee
Senior Personnel Planning and Development Committee
Senior Financial Resourcing Advisory Committee
Public Service Commission
Departments
LEGEND
Consultative/Advisory
Delegated Authority
Formal Reporting Relationships

17.20 The Advisory Group on Executive Compensation in the Public Service, composed of representatives from the private sector, advises and makes recommendations to the Prime Minister on Management Category compensation and related matters.

17.21 The Committee of Senior Officials on Executive Personnel, composed of deputy ministers and heads of central agencies, provides advice and information to the Clerk of the Privy Council concerning potential Governor in Council appointments, the performance of deputy heads, and other human resource policies for senior personnel.

17.22 The Staff Training Council, composed of deputy ministers and representatives of central agencies, assists Treasury Board in matters related to public service and management training. The Staff Training Council is supported by the Management Training Board, comprising assistant deputy ministers and equivalents. The Management Training Board deals exclusively with management training matters.

17.23 The Treasury Board Senior Advisory Committee, a deputy head level committee, provides advice to Treasury Board on major issues of management policy including administrative matters which relate to human resource management such as travel and relocation.

17.24 In addition, the Management Category Coordinating Committee, made up of Treasury Board and other central agency representatives, ensures co-ordination and advises the Deputy Secretary, Personnel Policy Branch of the Treasury Board Secretariat, on matters related to organization change affecting Management Category personnel and on other related issues.

17.25 The Senior Personnel Advisory Committee advises the Public Service Commission concerning appointments at the assistant deputy minister and equivalent level (EX 4, 5). Other committees, such as the Senior Personnel Planning and Development Committee and the Senior Financial Resourcing Advisory Committee, advise and assist deputy heads or other senior managers in the selection process for senior positions that have personnel or financial expertise requirements.

The Definition and Composition of the Management Category

The lack of a clear and consistent definition of "management personnel" and significant differences in the nature of responsibilities, the perceptions and attitudes of members of the Management Category work against the concept of an identifiable and cohesive managerial cadre. The fact that the Management Category does not include significant portions of the senior management team necessary to manage department and government programs restricts the deputy minister's flexibility. In addition, some policies and programs have failed to recognize the heterogeneous nature of the Category; consequently, they are not as effective as they could be.

17.26 Prior to the creation of the Management Category the top level management positions in the public service consisted mainly of those in the Senior Executive (SX) Category. Other management positions were dispersed among some 55 occupational groups and levels, each group having its own job evaluation and compensation plan. Hence the relative worth in job content of these top level managerial positions was not known and therefore could not be compared. The distribution of management positions among so many occupational groups was seen as detracting from a clearly defined, cohesive managerial cadre. It also failed to recognize the continuum of management responsibilities from the top levels of these occupational groups to the Senior Executive Category.

17.27 The Management Category was intended to re-group all the positions with managerial responsibilities under a common job evaluation plan that would be the foundation for an integrated and co-ordinated approach to human resource management for managers.

17.28 The initial objective was to group the Senior Executives (SX 1-4), the top levels of the Administrative and Foreign Service Category and the Scientific and Professional Category, and the top levels of some of the groups in the Technical Category. Managers at other levels were to be included progressively to form an overall managerial cadre of 10,000 or more. Medical officers and lawyers occupying positions below the assistant deputy minister level were not to be included because of their specialization and compensation.

Composition of the Management Category

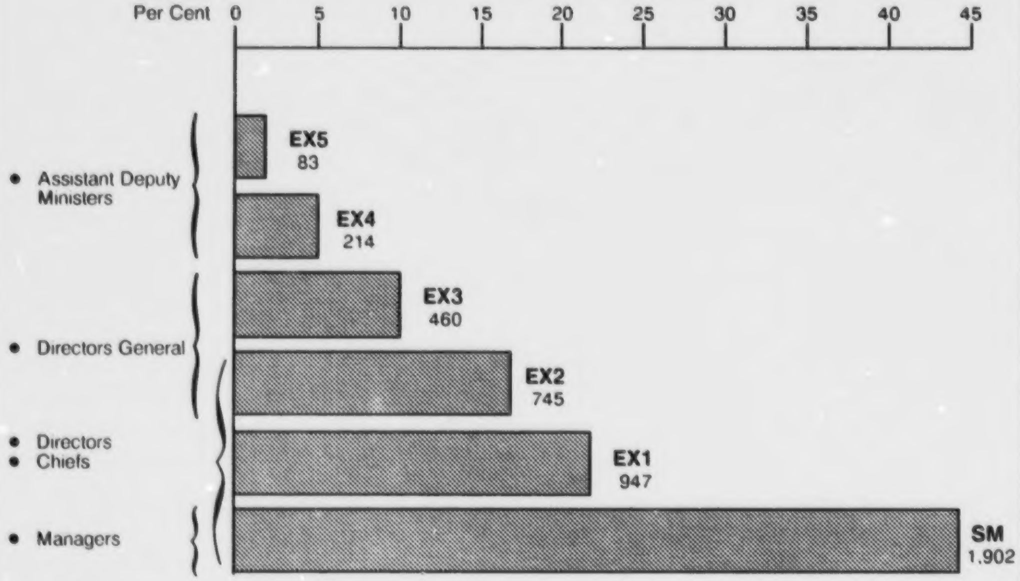
17.29 The creation of the Management Category permitted the grouping of many existing top-level positions under a common job evaluation plan. As of 31 December 1986, Public Service Commission records show 4,351 persons in the Management Category (Exhibit 17.3), compared to approximately 1,300 Senior Executives prior to the creation of the Category. The Management Category now represents about two per cent of the public service. The salary expenditure is in excess of $288 million.

17.30 The Management Category represents only part of most departmental management teams. For example, a number of persons with salary rates comparable to those of Executives and Senior Management ("pay equivalents") still occupy positions in groups and levels that in their entirety were supposed to be included in the Management Category. Treasury Board Secretariat statistics indicate that at least 805 persons are in "pay equivalent" positions. Of this number, 248, or 31 per cent, are excluded from collective bargaining, and others included in bargaining units appear to have managerial responsibilities. The top levels of some 11 occupational groups have been reviewed, modified or abolished since the creation of the Management Category. Classification standards for occupational groups and levels scheduled for inclusion in the Management Category have not all been revised nor has delegation of authority been completely withdrawn, thus permitting additional "pay equivalent" positions to be created. In one of the six departments audited, the Management Category constitutes slightly less than 50 per cent of the senior management team.

17.31 The plan to progressively expand the Management Category to include management positions at lower levels has not been carried out. Changes to the Public Service Staff Relations Act required and anticipated to facilitate the definition and process of identifying "persons employed in a managerial or confidential capacity" have not occurred. In addition, non-Management Category salary ranges have in some cases risen faster than those of the Management Category so that further expansion of the Management Category would require special arrangements to avoid loss of salary. In the six departments audited, there were numerous employees with managerial responsibilities who were not in the Management Category (Exhibit 17.4) and who, in some cases, were members of unions.

Exhibit 17.3

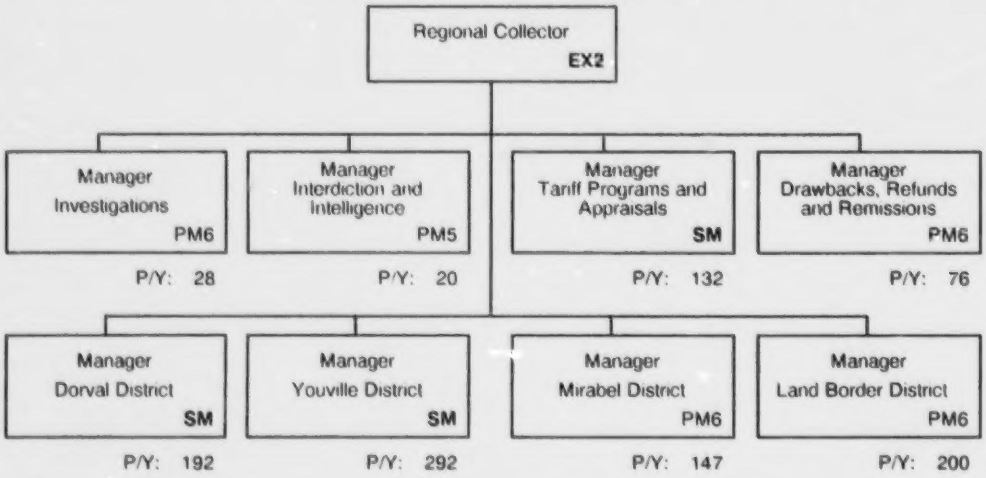
DISTRIBUTION OF MANAGEMENT CATEGORY POPULATION BY LEVEL AND PREDOMINANTLY USED TITLES (1986)



Source: PSC Annual Report (1986).

Exhibit 17.4

AN ILLUSTRATION OF A MANAGEMENT TEAM


Regional Collector
EX2
Manager
Investigations
PM6
P/Y: 28
Manager
Interdiction and Intelligence
PM5
P/Y: 20
Manager
Tariff Programs and Appraisals
SM
P/Y: 132
Manager
Drawbacks, Refunds and Remissions
PM6
P/Y: 76
Manager
Dorval District
SM
P/Y: 192
Manager
Youville District
SM
P/Y: 292
Manager
Mirabel District
PM6
P/Y: 147
Manager
Land Border District
PM6
P/Y: 200

PM = Program Administrator
P/Y = Person-years assigned to the manager

This modified organization chart illustrates a management team with four out of nine positions classified in the Management Category (EX2, SMs) despite the fact that all nine incumbents are excluded from collective bargaining.

Lack of a Clear and Consistent Definition of "Management Personnel"

17.32 Our examination of central agency Management Category policies and practices produced no evidence of a clear and consistent definition of "management personnel" that could be or that has been used as a basis for developing and applying human resource policies and programs to the senior cadre. Various definitions exist but they are not consistent. For example, the "Management Category Complement", limiting the number of senior positions allocated to departments by Treasury Board, includes both Management Category and "pay equivalent" positions, many of these filled by persons who are members of bargaining groups. But the Management Category Exclusion Approval Order, which generally permits deputy heads to deploy staff without the full constraints of the regular staffing system, applies exclusively to Management Category personnel. Other policies such as the Vacation Leave Policy apply to Management Category personnel and to "excluded or unrepresented employees" (that is, employees not covered by collective bargaining at specific levels of various occupational groups).

17.33 Our audit work in central agencies revealed that there is no agreement on whether the Management Category does or should constitute a service-wide and/or a departmental resource except in the case of those at the assistant deputy minister and equivalent level who are mainly perceived as a service-wide resource.

The Effects

17.34 The lack of a clear and consistent definition of who constitutes "management personnel" in departments and in the public service directly affects the degree to which persons can identify with management at the government-wide or departmental level.

17.35 Deputy heads' flexibility to deploy management personnel is restricted in that the Exclusion Approval Order applies only to those in the Management Category.

17.36 The efficiency and effectiveness of other human resource policies, programs and practices, such as selection, training and development, compensation and pay for performance, are also affected because, in part, they are based on an assumption of a commonality of values, knowledge, skills and interests among persons performing managerial functions. For example, in establishing the Management Category, emphasis was to be placed on more rigorous selection practices to ensure a minimum level of managerial experience and competence on entry to or promotion through the managerial ranks. Although the Public Service Commission developed draft selection guidelines that required minimum common managerial qualifications, the application of these selection guidelines was discontinued because of the need for specialized knowledge and skills and because of the significant differences in the nature of Management Category positions. For example, 14 per cent of our questionnaire respondents at the Senior Management level claimed they did not have any resources (dollars or personnel) allocated to them for 1986-87. In comparison, 23 per cent at the same level claim to supervise or direct from 51 to more than 500 people.

17.37 Mandatory orientation training programs for Management Category members were established in 1981, based also on the assumption that there was a need for a common core of knowledge and management skills required at the various levels of the Management Category. However, we also found that there are great differences in the education, experience, knowledge and skills required for positions at the same level. For example, some positions require a professional designation, such as accounting, or a university degree in a scientific discipline; others have no such requirements. A Treasury Board Secretariat evaluation of the orientation programs resulted in 20 recommendations. According to Treasury Board Secretariat records, 18 have been addressed. Recommendations still being considered pertain to the exemption from mandatory training of some managers who were converted to the Category and to the need to restructure course content to recognize the varying levels of knowledge and skills required of Management Category personnel. Although the Public Service Commission has stated its intention to restructure orientation training, agreement on what should be included has not yet been reached by those responsible.

17.38 The departmental managers and central agency officials we interviewed were of the opinion that there was insufficient service-wide human resource and career planning for senior levels. However, there were diverse views about the extent and nature of such planning because, except for the assistant deputy minister and equivalent level, there is no agreement on whether the Management Category constitutes a public service and/or a departmental resource.

17.39 In our opinion, improvements in many Management Category programs cannot be made without making fundamental decisions about such matters as the definition and composition of the Management Category and the extent to which Management Category personnel constitute a government-wide and/or departmental resource and require a common core of knowledge and skills.

17.40 It has been almost seven years since the creation of the Management Category. Because many changes have occurred during this period that affect management personnel (for example changes in government, downsizing, etc.), a review of Management Category objectives and programs should in our opinion be undertaken to ensure that they meet the present needs of the public service.

17.41 Treasury Board should clarify the definition and composition of the Management Category including the extent to which it constitutes a service-wide and/or a departmental resource.

17.42 In doing so, it should take into consideration government objectives and priorities for the public service as well as service-wide and departmental needs for a clearly identifiable and cohesive managerial cadre.

17.43 Management Category programs, systems and policies should be re-assessed to ensure that they are consistent with the clarified definition and composition.

Management Category Job Evaluation Practices

Neither the management nor the operation of the Management Category Position Evaluation Plan is carried out in a manner that provides internal relativity between Management Category positions and assurance of consistency of classification decisions within and among departments. Job evaluation results do not provide a reliable basis for external compensation comparisons. Treasury Board Secretariat has not devoted sufficient resources to the Management Category job evaluation function, and this has contributed to some of the weaknesses identified. The current state of job evaluation practices does not allow as planned for the delegation of Management Category classification authority.

17.44 One of the objectives of the Management Category was to provide for a uniform and common conceptual approach to compensation through a uniform classification system for all managers, providing for internal relativity between Management Category positions. The achievement of this objective is dependent largely on the integrity and consistency with which the Management Category Position Evaluation Plan, the current system for determining the relative value and classification level of Management Category positions, is applied.

17.45 Job evaluation results are also used as the basis for comparing Management Category compensation with other sectors of the economy. Therefore, it is critical that the Position Evaluation Plan be applied in a manner that provides for effective compensation comparisons.

Conversion of Positions to the Management Category

17.46 The job evaluation method used for the former Senior Executive group was not considered appropriate for the Management Category. Treasury Board, having considered various options, decided to implement a method of job evaluation used widely in other sectors of the economy. This job evaluation method provided for improved compensation comparisons with these other sectors.

17.47 The creation of the new Management Category was undertaken in phases. The first phase (1980-81) included the conversion of the Senior Executive Category and "equivalent" positions including the most senior Foreign Service Officer positions. The second phase (1981-82) focused on converting top-level positions in the Scientific and Professional, Administrative and Foreign Service Categories and the top levels of certain occupational groups in the Technical Category. A third phase was necessary to complete the conversion of certain Foreign Service positions in the Department of External Affairs. This was carried out as a separate exercise and was completed in 1984.

Costs and Effects of Conversion

17.48 The conversion of positions to the Management Category consisted of re-evaluating more than 4,500 positions at an estimated cost of $10 million over a period of five years.

17.49 The process followed for converting positions to the Management Category resulted in significant differences in the manner in which the Management Category Position Evaluation Plan was applied across and within departments. Even taking into consideration the size of the task, we would have expected that, given the time that has elapsed since conversion, the inconsistencies would have been addressed. Instead we found that many have remained unresolved.

17.50 Inconsistencies in the application of the Management Category Position Evaluation Plan at conversion have worked against achieving internal relativity between Management Category positions and compensation comparability with other sectors of the economy. For example, because of different human resource practices as well as weaknesses in the conversion process, the results of job evaluations in the Department of External Affairs were significantly different from those of other departments. As a result, Treasury Board Secretariat has excluded all External Affairs Executive 1 level positions from external compensation comparisons even though External Affairs positions represent 20.5 per cent of all Management Category positions at the Executive 1 level. Thus the basis for external compensation comparisons is not representative of the Management Category as a whole and brings into question the inclusion of External Affairs positions in the Management Category.

17.51 Conversion results have had a negative effect on employee morale, particularly at the Senior Management level. Some members of the Management Category had to be paid at their former salary levels because they were higher than those of their new Management Category positions (salary protection). As a result, the salary ranges of some subordinates severely overlapped or exceeded those of the members of the Management Category to whom they reported (salary compression and inversion). This has had a negative impact on the acceptance and attractiveness of the Management Category.

Post-conversion Job Evaluation Practices

17.52 Good job evaluation practices provide for internal relativity and are the basis for equitable salary administration. To achieve this requires the fair and consistent application of valid job evaluation standards by competent personnel trained and experienced in using the standards and thoroughly familiar with the organization and with the position to be evaluated.

17.53 We found serious weaknesses in the management, operation and maintenance of the Management Category job evaluation system.

Incomplete Job Evaluation Standards

17.54 A critical element of the job evaluation method chosen to evaluate Management Category positions is the existence of key positions (benchmarks) which, properly evaluated and classified, serve as references in evaluating jobs. Although benchmarks were originally established for the Management Category, they have fallen out of use. Weaknesses in this area were brought to the attention of the Treasury Board Secretariat by consultants in 1985; however, to date the Treasury Board Secretariat has not replaced the benchmarks. As a result, Management Category job evaluation decisions are made without the additional assurance that benchmarks normally provide. The existence of benchmarks could facilitate the achievement of job evaluation consistency within and across departments.

Absence of Management Training and Participation

17.55 There is a general absence of management training and management participation in the Management Category job evaluations process despite Treasury Board policy. This results in managers not assuming ownership or responsibility for maintaining consistency in the application of the Position Evaluation Plan. It also impedes their communications with specialists when dealing with Management Category job evaluations. The understanding of Management Category members of the Position Evaluation Plan influences the degree to which they appreciate the need for high quality job descriptions, the importance of consistent evaluations and accept job evaluation results.

Insufficient Resources and Inadequate Specialist Training

17.56 In many ways, the people responsible for applying the Management Category Position Evaluation Plan determine its effectiveness and efficiency.

17.57 Treasury Board Secretariat has not devoted sufficient resources to deal with the high volume of job classification activity. To remedy this situation partly, departmental job evaluation specialists or contract personnel are borrowed or hired. Job evaluation specialists in the Treasury Board Secretariat recognize that this practice may not be conducive to good and consistent job evaluation results. Delays of three months or longer in obtaining Management Category job evaluation decisions have also occurred, negatively affecting departmental operations. The lack of resources also impairs the ability of Treasury Board Secretariat to review and correct deficiencies brought to its attention over time.

17.58 Although departments do not have delegated authority for classifying Management Category positions, they are responsible for preparing and submitting job descriptions, job evaluation rationales and recommendations to Treasury Board Secretariat. Departmental job evaluation specialists have not always been provided with training in the Management Category Position Evaluation Plan needed to ensure adequate advice to departmental senior management, to prepare high quality documentation and to liaise effectively with the Treasury Board Secretariat. At present, the prescribed training for the certification of job evaluation specialists includes a half-day session on the Management Category Position Evaluation Plan; no on-the-job training is required.

17.59 The inadequate training of departmental job evaluation specialists has resulted in passing to management some misconceptions about the Position Evaluation Plan. For example, there is the common belief that there must be a two-level difference between boss and subordinate positions in the Management Category. Although such a difference may be appropriate and justified in some cases, there are other situations where it may not be.

Some Features of the Position Evaluation Plan Are Not Used

17.60 Some features built into the job evaluation method to provide an effective system of checks and balances to assess reliability and consistency of job evaluation results are not being used, despite the fact that the method was selected in part because of these features. Using some of them, our Office conducted a computer test which revealed that all but two Management Category positions had the same requirements for human relations skills. This is surprising given the vast differences in the types of responsibilities among Management Category positions. The test also disclosed that only two of all Management Category job evaluation results recognize the requirement for "exceptional mastery" or "eminent authority" in scientific or other learned disciplines, despite the fact that a number of policy advisory positions and positions requiring a high level of specialized knowledge were included in the Management Category.

17.61 Failure to use all the features of the job evaluation method reduces the effectiveness of the Position Evaluation Plan, in that areas that should be examined for possible inconsistencies are not investigated. For example, inadequate consideration of the depth of knowledge requirements of some positions could mean the under-evaluation of a number of Management Category positions.

Questionable Classification Level Boundaries

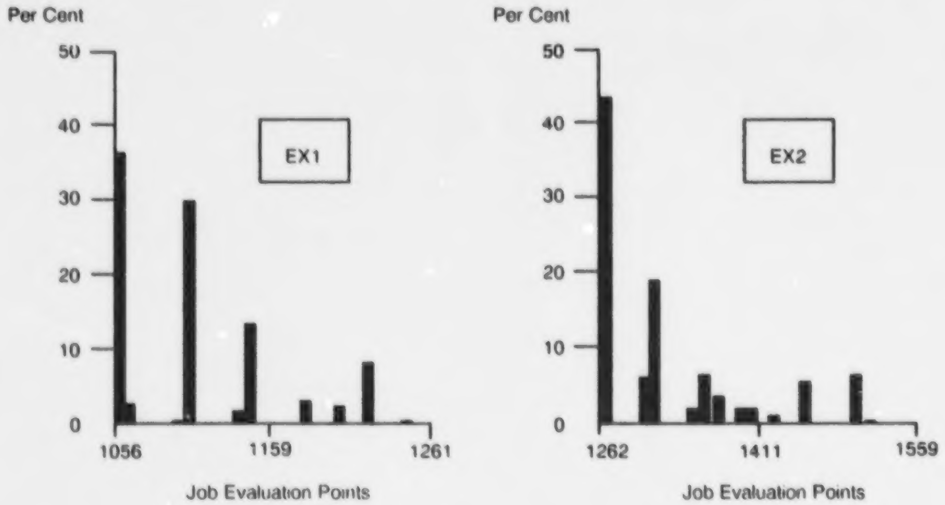
17.62 There are currently five levels in the Executive group and one in the Senior Management group. The level of each Management Category position is determined by the job evaluation process which results in a total point value. This point value determines the classification level of the position. For example, all positions within the point boundaries of 835 to 1,055 are classified in the Senior Management group. For various reasons, the point boundaries delineating the levels were not set in accordance with normal compensation practices. We found an unusually large percentage of positions (up to 40 per cent or more at certain levels) are at the minimum number of points for a given level (see Exhibit 17.5). This percentage has increased since 1985, suggesting that some evaluations are being "stretched" to meet the requirements of the level.

Inadequate Management Information

17.63 Current and accurate information on Management Category positions and job evaluation results is vital to managing the job evaluation function effectively. It is also essential to other activities such as staffing and controlling the number of Management Category personnel. Treasury Board Secretariat has informed us that the Senior Personnel Information System, created in 1981 to provide information on the Management Category (including job evaluation results and classification decisions), had design flaws, was costly and ineffective;

Exhibit 17.5

PERCENTAGE DISTRIBUTION OF JOB EVALUATION RESULTS AT THE EXECUTIVE 1 AND 2 LEVELS



The graphs illustrate the distribution of job evaluation results of positions at the EX1 and EX2 levels. An unusually large percentage of positions have results that are at the minimum required for the level.

consequently it did not evolve as intended. In its place, Treasury Board Secretariat now has microcomputer applications that it says have reduced direct operating costs from $200,000 a year to approximately $20,000. Although we recognize the efforts made by Treasury Board Secretariat to bring about improvements in this area, we are still concerned that serious deficiencies in the quality of the information have yet to be addressed. For example, Treasury Board Secretariat has been unable to maintain reliable information on changes in the utilization of Management Category personnel and positions. Such information is necessary to ensure that the limits on the number of senior personnel, including those in the Management Category, are not exceeded.

Inadequate Monitoring, Review and Audit

17.64 There is no periodic, systematic review of the validity of Management Category job evaluation results.

17.65 We also found that, in the central agencies examined, there was no auditing of the classification of Management Category positions. An ad hoc review of Management Category job evaluations was conducted by consultants and Treasury Board Secretariat personnel in 1983. The results of this review, reported in 1985, revealed serious deficiencies in the operation and maintenance of the Management Category job evaluation system. Treasury Board Secretariat was alerted to the need for further review and the need to implement corrective measures such as establishing and rigorously using and controlling benchmarks, as well as instituting an ongoing process for auditing Management Category job evaluations results. However, we found little evidence of corrective action.

The Effects of Job Evaluation Practices

17.66 Analysis of Treasury Board information indicates that more than 40 per cent of Management Category job evaluation results (excluding External Affairs) reflected a lack of consistency in the application of the Plan, particularly across departments. Coupled with the fact that point boundaries delineating the levels have not been set in accordance with normal compensation practices, an audit of Management Category job evaluations would probably result in identifying a high level of both over-and under-classifications.

17.67 In our opinion the government objective for establishing internal relativity among positions in the Management Category has not been achieved.

17.68 Interviews and questionnaire results indicated concern about the inconsistent application of the Management Category Position Evaluation Plan, particularly across departments. Questionnaire results indicated that 62 per cent of the respondents perceived that the Position Evaluation Plan was applied inconsistently across departments; 19 per cent perceived it to be applied consistently. Others were neutral.

17.69 A number of persons at the Executive 1 and Senior Management levels perceived that job evaluation did not take into account all requirements of their positions and, as a result, they believed that their positions were not properly classified. At the Executive 1 level, 55 per cent saw their classification as appropriate; 45 per cent believed it was not. At the Senior Management level, 51 per cent believed the classification of their positions was appropriate; 49 per cent stated it was not.

17.70 Prior to the creation of the Management Category, departments had the delegated authority to classify positions in the Senior Executive (SX) group up to and including the Senior Executive 2 level. A number of senior departmental personnel were of the opinion that the authority to classify certain Management Category positions should be re-delegated to departments as originally intended. However, the weaknesses that have been identified prevent any movement in this direction at this time.

17.71 During our audit, Treasury Board Secretariat took initiatives to address some of the deficiencies that have been brought to its attention over time, including the lack of training and the lack of consistency in job evaluation results. In our opinion, other deficiencies identified in this audit, such as lack of benchmarks and the lack of an audit capability, must also be addressed if substantial improvements are to be expected in the operation and management of the function.

17.72 **Job evaluation practices for the Management Category should be improved to ensure internal relativity between Management Category positions and to**

provide a sound basis for equitable salary administration and external compensation comparability.

Salary Administration and Other Compensation Practices

Current compensation practices do not support the attainment of the government's objectives of internal compensation relativity and compensation comparability with other sectors of the economy. This results in the inequitable treatment of some members of the Category. It also impedes the effectiveness and reduces the credibility of other Management Category programs.

17.73 The government's policy on compensation for the Management Category provides for comparison of both salary and benefits (total compensation) with other sectors of the economy up to and including the Executive 1 level, and for appropriate salary differentials above the Executive 1 level.

17.74 The underlying assumption was that implementation of this policy, along with anticipated changes to the Public Service Staff Relations Act that would have capped salary increases arising from arbitration decisions, would eventually permit compensation relativity between the Management Category and the top levels of collective bargaining groups. It was expected that this would provide for a reasonable salary progression between all levels and make it easier to attract and keep qualified staff. Over time it would eliminate the long-standing problem of subordinates' salaries greatly overlapping or exceeding those of their Management Category immediate supervisors (salary compression and inversion). However, this approach to compensation has not been fully implemented. Anticipated changes to the Public Service Staff Relations Act have not been made. As a result, despite apparent improvements, Treasury Board Secretariat reports a high incidence of salary compression and inversion between the top levels of certain bargaining groups and the lower levels of the Management Category.

Salary Compression and Inversion

17.75 Salary compression occurs when the salary range of a subordinate severely overlaps the salary range of the superior. Salary inversion occurs when the maximum salary rate of a subordinate exceeds the maximum salary rate of his or her superior. There are no generally accepted rules for determining when salary compression occurs and when compression and inversion become unacceptable. Some degree of salary compression and inversion exists in most organizations; for example, when the salary of a professional exceeds the salary of the generalist manager to whom he or she reports. There is, however, agreement that, except in rare circumstances, supervisors should have access to compensation levels higher than their subordinates.

17.76 Treasury Board Secretariat in its 1987 Memorandum to the Advisory Group on Executive Compensation stated that 30 per cent of employees at the Senior Management level have subordinates who have access to higher salary rates. It also stated that 90 per cent of those converted to the Senior Management level would be earning more today had they not been converted to the Management Category. However, these Treasury Board Secretariat data do not take into account salary protection or promotions since conversion. Although the Secretariat's 90 per cent figure is higher than the results indicated by our questionnaire (55 per cent), there is no doubt that a large number of Senior Management personnel would earn more today if they had remained in their former groups and levels. In one division of a department we audited, five Senior Management level positions had a maximum salary of $60,400, instead of the $66,943 they would have had if they had not been converted to the Management Category. One other management level position had a maximum salary of $66,108. At the time of our audit, 25 of the 62 subordinates reporting to the SMs in that organization had access to a higher salary level than SMs. Such situations reflect some significant differences in the compensation practices between the Management Category and other occupational groups.

17.77 Salary compression and inversion have a significantly greater effect on departments with large scientific and professional populations; however, departments with populations in other occupational groups have also been affected.

17.78 Because of salary inversion or because of the small differentials in salary ranges between the top levels of certain occupational groups and the Management Category, a person "promoted" to the Senior Management level may receive no increase in salary or may have to accept a lower salary. Treasury Board Secretariat stated that 58 per cent of employees considered as "feeders" to the Senior Management level would not receive an increase in salary if "promoted" to that level.

17.79 Close to 15 per cent of all employees at the Senior Management level earn more than the maximum salary rate for their level because of salary protection or lump-sum payments to compensate for no longer having their salary protected. These special pay practices for such a large number of employees do not contribute to simplifying pay administration nor do they support the principle of pay equity. There are no indications of these special pay practices being phased out despite the 1981 objective to do so within one to five years.

17.80 Compensation problems have had an impact on the plan to expand the Management Category to lower levels. In a 1980 pre-test to determine the effect of converting management positions at the Program Administrator 6 (PM6) and equivalent level to the Management Category, Treasury Board Secretariat determined that almost all the incumbents of such positions would require salary protection to avoid loss of salary. The salary range of their occupational group was higher than their salary range would have been in the Management Category.

17.81 Salary compression and inversion and other compensation problems have caused resistance on the part of some people to join the Management Category. Departments with scientific and professional populations are finding it difficult to fill certain vacant Senior

Management positions from their ranks. This causes them to use other classification standards for evaluating the position or long-term assignments or acting appointments to fill these Senior Management positions.

17.82 Salary compression and inversion problems have also had a negative impact on the identification and cohesiveness of the managerial cadre. For example, some departments have pressed the Treasury Board Secretariat to "de-convert" Senior Management positions to their former groups and levels. To become a member of the management team at the Senior Management level is not always seen as desirable.

17.83 The current level of salary compression and inversion with subordinates is a major issue affecting the Management Category. The level of dissatisfaction and frustration was most pronounced at the Senior Management and Executive 1 levels.

17.84 Treasury Board Secretariat has recently proposed measures to the Advisory Group on Executive Compensation to alleviate problems caused by salary compression and inversion. However, we are not convinced that all possible causes of the problem have been identified and investigated. For example, there is no indication that the serious inconsistencies, noted earlier, in applying the Management Category Position Evaluation Plan have been given adequate consideration in determining why salary compression and inversion exist and how they could be stopped. Possible inconsistencies in job evaluation results for other occupational groups should also have been taken into account.

17.85 Finally we are concerned by the possible pressure for higher classification levels that may be put on the Management Category job evaluation system to alleviate salary compression and inversion or other compensation problems.

Possible Causes of Salary Compression and Inversion

17.86 As long as the definition and composition of the Management Category remain unclear (that is, which positions should be included and which should not) and as long as the Management Category Position Evaluation Plan is not applied consistently across departments, it is not possible to determine the degree and exact causes of salary compression and inversion. We attempted to isolate some of the causes of this long-standing problem, which has been discussed periodically by the Advisory Group on Executive Compensation since its first report in 1968. Although we identified many possible causes, we could not single out the most important, nor could we establish a direct cause-effect relationship.

17.87 There is no definition of or agreement on what might constitute acceptable compensation practices in the public service. For example, what relationship, if any, should exist between the compensation paid to members of Parliament and the top echelons of the public service? Should scientific and professional personnel be allowed to progress in their careers and salaries in parallel to those in the Management Category? Should the Management Category capture all employees beyond a certain point in the hierarchy and the salary structure? How much salary compression or inversion is reasonable, and at what point does it become unacceptable? The decision to exclude Medical Officer and Lawyer positions below that of assistant deputy minister or equivalent level indicates that, initially, central agencies accepted that persons in these occupational groups could have access to career and salary progression that run parallel to those in the Management Category. Should this principle be allowed for other occupational groups? Which ones?

17.88 The difference between the approach and methodology used in determining Management Category compensation and those used for collective bargaining groups, and the lack of co-ordination between the two, may also contribute to the problem of salary compression or inversion. For example, compensation for bargaining groups is either the result of direct negotiations with the employer (Treasury Board) or of an arbitration award from an independent third party. Management Category compensation is determined by the employer, preceded sometimes, but not always, by advice and recommendations from the Advisory Group on Executive Compensation.

17.89 Generally, occupational groups subject to collective bargaining have not been subject to the same compensation decisions as the Management Category. For example, salary range increases were zero per cent for 1985 and two per cent for 1986 for the Senior Management group, while bargaining groups, according to Treasury Board Secretariat, received an average of 3.75 per cent for 1985 and 3.5 per cent for 1986.

17.90 The employer and bargaining groups use either compensation survey data obtained from the Pay Research Bureau of the Public Service Staff Relations Board or compensation comparisons with other federal public service occupational groups as a basis for negotiations or for presentations at arbitration hearings. For the Management Category, Treasury Board Secretariat's primary source of compensation information is the consultants that own the copyright on the Management Category job evaluation method. Until 1986, Pay Research Bureau's Management Category compensation surveys were considered a secondary source of information. From time to time additional compensation survey data have also been used to verify trends in salary increases.

17.91 There are significant differences in the methodology used and in the universe covered by these various surveys. For example, Pay Research Bureau salary surveys for bargaining groups may include provincial or municipal governments. Pay Research Bureau includes different organizations for each occupational group salary survey as well as for its benefits survey. Further, the Pay Research Bureau does not measure the costs of benefits but rather their frequency of occurrence. Thus, for bargaining groups, a measurement of total compensation (salary and cost of benefits) is not done.

17.92 Unlike Pay Research Bureau salary surveys, Management Category salary surveys do not include provincial and municipal governments. However, Management Category total compensation surveys measure the cost of both salary and benefits in all other sectors of the economy including municipal, provincial and the federal governments.

17.93 Because survey methodology, universes and pay policy as applied differ, there is no common basis to compare the results of compensation surveys carried out for the Management Category and for the bargaining groups.

17.94 Differences in survey universes alone are sufficient to produce substantial variations in survey results. A formal request by the Advisory Group on Executive Compensation to Treasury Board Secretariat to clear up differences in compensation survey results for the Management Category and other occupational groups has not yet been addressed. Furthermore, Pay Research Bureau's Management Category compensation surveys have been discontinued by Treasury Board Secretariat.

17.95 Weaknesses in the application of the methodology used to determine the comparability of Management Category compensation may also have contributed to the problem of salary compression and inversion. For example, to achieve a valid external compensation comparison, it is essential that the Management Category Position Evaluation Plan be applied consistently. As outlined earlier, this is not the case.

17.96 In addition, the sample of positions chosen by the Treasury Board Secretariat as a basis for external compensation comparisons is not representative of the overall job evaluation results in the public service. For example, some departments with large numbers of Senior Management or Executive 1 level positions, with inconsistent job evaluation results compared to other departments, were either not included in the sample or not proportionately represented. Depending on the sample of positions chosen, compensation survey results could vary by as much as 10 per cent or even more.

17.97 In 1985 and again in 1986, consultants informed Treasury Board Secretariat that the basis for external compensation comparisons was not representative of all positions or of all departments. Despite this, Treasury Board Secretariat continues to place a great deal of reliance on compensation results obtained through the use of these samples. This information is provided to the Advisory Group on Executive Compensation, which in turn advises and makes recommendations to the Prime Minister concerning Management Category compensation.

17.98 In our opinion, compensation practices affecting the Management Category may have concentrated on external comparability at the expense of internal relativity. Inherent difficulties and weaknesses in establishing a valid comparative base with other sectors raise serious questions about the validity of this approach. Although it is important for public sector compensation to pass the test of compensation comparison with other sectors, it is equally important, if not more so, that internal relativity be respected. It is questionable whether current salary compression and inversion can be resolved while trying to maintain external comparability as a primary principle.

17.99 The lack of an adequate resolution of the long-standing issue of salary compression and inversion is reflected in the scepticism and cynicism expressed particularly at the Senior Management level where it is viewed as a sign that SM concerns are not considered important. Disillusionment and frustration and the absence of tangible signs that they are a key government resource affect their sense of identification and commitment to some Management Category programs.

17.100 Compensation management and salary administration practices should ensure improved compensation relativity between the Management Category and the rest of the public service as well as with other sectors of the economy.

Performance Management Practices

Although there has been considerable effort invested in performance management practices for the Management Category, the manner in which performance pay is administered limits its overall effectiveness and the ability of departments to reward high performers. Departments are making an effort to improve performance management; however, they are hindered by complex legislation and administrative requirements.

Performance Review and Employee Appraisal

17.101 A good performance management program should include establishing and communicating performance expectations, regularly reviewing performance and providing feedback to the employee concerned, and giving an appropriate level of recognition and response to both good and poor performance.

17.102 In half the departments surveyed, considerable effort has been invested in performance reviews and employee appraisal practices for the Management Category. Audit work and questionnaire results indicated that a high percentage of appraisals were completed annually and that, with the exception of the performance rating and its link to pay for performance, most Management Category members were satisfied with the performance appraisal process – including the extent of objective-setting, feedback from their supervisors about performance achievements, and the extent to which the narrative written by their supervisors reflected their performance.

17.103 Questionnaire results indicated that for 73 per cent of respondents, expectations were formally established at the beginning of the period under review, and in 84 per cent of those cases departmental or unit work plans were an important part of the process. More than half of those who perceived a need for feedback were afforded that opportunity. Close to 70 per cent of the respondents thought that the narrative comments on the appraisal reflected their performance, and 66 per cent agreed that their appraisals reflected achievements.

Pay for Performance

17.104 The pay-for-performance plan for Management Category personnel has two components: a permanent increase to salary in the form of a "merit increase" up to the maximum of the salary range for the position, and a lump sum performance award (bonus) paid to "superior" and "outstanding" performers once they have reached the maximum salary for their levels. Merit increases range from 3 to 5 per cent of salary for "fully satisfactory", 5 to 7 per cent for "superior", and 7 to 10 per cent of salary for "outstanding" performers. Bonuses can reach up to 7 per cent of salary for "superior" and up to 10 per cent for "outstanding" performers. Merit increases and bonuses are over and above any adjustments to salary ranges that may be made from time to time. Deputy heads are allowed to exercise discretion in allocating pay for performance within these guidelines and within the performance pay budgets established by Treasury Board.

17.105 According to documentation published at the time the Management Category was set up, pay for performance was to be the heart of compensation for the Management Category. However, because of general restraint measures, pay for performance was virtually not applied for the first three years following the creation of the Management Category. A recent government initiative has re-affirmed pay for performance as a permanent feature of the compensation policy for the Management Category.

17.106 When questionnaire respondents were asked to rate their relative degree of satisfaction or dissatisfaction with various human resource practices, pay for performance had the highest level of dissatisfaction. Questionnaire results indicated that 47 per cent of respondents were dissatisfied with pay for performance, while 26 per cent were satisfied; others were neutral.

17.107 The pay-for-performance plan for Management Category personnel limits the departmental senior management authority to allocate merit increases that clearly distinguish between levels of performance. For example, the difference in the merit increase between "fully satisfactory" and "superior" performance ratings can be as low as two per cent. These current pay differentials are not seen by many Management Category members as sufficient to recognize the additional efforts required to achieve higher levels of performance. Furthermore, pay for performance only applies to a portion of departmental senior personnel.

17.108 A performer rated "fully satisfactory" (defined in Treasury Board policy as an admirable level of performance) and who is at the maximum salary is not eligible for a performance bonus. With more than two-thirds of Management Category employees at maximum salary (or above because of salary protection) – and with potentially 20 per cent more of them at this level in 1987 – an increasingly greater number of Management Category employees will not be eligible to receive monetary performance reinforcement unless their performance is rated "superior" or "outstanding".

17.109 This is also a concern for individuals entering the Management Category through promotion from some levels of professional, scientific and other groups. Because of the small differential between salary rates, or because of salary compression and inversion, they may receive no salary increase on appointment. In some cases they may have to accept a lower salary only to find that they are at the top of the new salary range. They then realize that they cannot be eligible for merit pay and are not entitled to bonuses even with a "fully satisfactory" rating.

17.110 Although departments audited used various ways to review performance, review activities primarily focused on ensuring that the proper number of "superior" and "outstanding" performers were identified and justified for pay-for-performance purposes. Several approaches were used in applying pay for performance, ranging from a rigid "quota" on "superior" and "outstanding" performance ratings to more flexible approaches.

17.111 Those who supervise other Management Category personnel expressed concerns about a perceived lack of equity in the manner in which performance is rated in their departments because of the highly subjective nature of judgements about performance and the differences in rating style among managers. Fifty-two per cent of supervisors of Management Category personnel were dissatisfied with the equity of performance ratings in their departments. Only 17 per cent were satisfied. Others were neutral.

17.112 Supervisors appear to have little authority or influence over the actual dollar amounts their Management Category subordinates receive. Questionnaire results indicated that 60 per cent of supervisors of Management Category personnel were dissatisfied with the authority or influence they had over the amount of merit increase or bonuses their subordinates receive; 19 per cent were satisfied. Others were neutral. Close to 50 per cent of respondents below the Executive 3 level perceived that their superiors had no or limited influence on the merit increase or bonus they received.

17.113 Because of inconsistencies in the data provided by Treasury Board Secretariat and the Public Service Commission, we were unable to assess the exact distribution of performance ratings by level. However, we were able to determine that two ratings are used most: "fully satisfactory" and "superior". We were also able to determine that the percentage of members rated "superior" or "outstanding" increases with each successive level of the Management Category.

17.114 This skewed distribution of performance ratings across levels raises several questions about the purposes and uses of performance ratings and pay for performance. For example, are performance ratings the measure of the degree to which predetermined objectives have been met? Or are they the measure of the performance of an individual in relation to his or her peers? Are performance ratings at the senior levels used to motivate by partly compensating for limited salary increases or for salary ranges that are below market value? Are the lower levels of the Management Category receiving their fair share of pay for performance? If so, should the central agencies be concerned about the relatively lower number of high achievers at lower levels of the Management Category considering that they are part of the feeder groups to higher levels?

17.115 In 1987, the government provided a productivity bonus for members of the Management Category. One per cent of salary was paid to "fully satisfactory" and 1 1/2 per cent to "superior" and "outstanding" performers. It is not known whether this productivity bonus will continue in future years or how it will affect pay for performance or the compensation policy for the Management Category.

Handling Performance Problems

17.116 The statutory basis for rejecting probationary public service employees whose performance is not satisfactory is section 28 of the Public Service Employment Act. Section

31 provides for release or demotion on grounds of incompetence or incapacity. Terms and Conditions of Employment for the Executive group and the Senior Management group provide for discharge for disciplinary reasons. In addition to these provisions, Treasury Board Secretariat has issued a number of measures under the Management Separation Policy that provide for a flexible approach to the problem of inadequate performance of Management Category personnel.

17.117 Departments are making efforts to identify and address performance problems in the Management Category. Several options are used to address problem performers, including coaching and training, secondments, transfers and re-assignments at the departmental or inter-departmental level. Separation pay is also used from time to time.

17.118 One of the key problems in addressing poor performance is that the performance review and appraisal process does not appear to be used by managers to identify Management Category problem performers and does not support a proper formal remedial approach. There is a traditional reluctance to rate an employee "satisfactory" or "unsatisfactory" because of the impact this may have on future career moves. "Satisfactory" and "unsatisfactory" represent one or two per cent of all Management Category performance ratings (depending on the data source used). Paradoxically, the use of higher ratings may render the poor performer eligible for pay for performance. It appears that only extreme cases can be addressed under the provisions of current legislation, and that the multiplicity of legislative and other provisions, each with its separate redress mechanism, does not facilitate the resolution of these problems; it acts as a constraint.

17.119 We found a high degree of concern on the part of supervisors of Management Category personnel about the inability of senior management to address serious performance problems through release or demotion when other approaches fail.

17.120 The 1979 Lambert Commission Report recommended that legislation be enacted to ensure that unsatisfactory performance be considered as a basis for release. The D'Avignon Report suggested that the different redress mechanisms be simplified through unification. These recommendations, and other related ones, have not been implemented.

The Effects of Performance Management Practices

17.121 The lack of a continual provision of pay for performance over the years, coupled with constraints in the application and operation of the program, is perceived by Management Category members as a lack of commitment to what is supposed to be the heart of compensation. Further, it has reduced the program's effectiveness.

17.122 In our opinion, performance ratings as currently used do not encourage higher levels of performance or facilitate the resolution of performance problems. Overall performance ratings may detract from, rather than support, the overall objective of the performance review and appraisal process to provide feedback to individuals and identify strengths and weaknesses for the benefit of performance improvements. For example, an individual who receives a "superior" rating one year and a "fully satisfactory" rating the next, because of different raters, may perceive that his or her level of performance has deteriorated. This can be demoralizing.

17.123 Current practices can create pressure to inflate performance ratings or to rotate the higher ratings among staff. They may lead to a tendency in some cases to transfer the responsibility of handling performance problems to other managers or to agencies such as the Public Service Commission acting in its placement or "brokerage" function.

17.124 Treasury Board Secretariat is currently reviewing the performance review and employee appraisal policy for the Management Category. It is not known when this review will be completed or if it will address all the concerns identified during this audit.

17.125 **Treasury Board should review the administration of pay-for-performance practices with a view to improving the relationship between the results of the Management Category performance review and employee appraisal process and the allocation of pay-for-performance awards.**

Resourcing Practices

The Management Category Exclusion Approval Order has provided deputy heads with increased flexibility in deploying and using Management Category personnel. However, some resourcing practices have not evolved as originally envisaged and communicated. As a result there is no assurance that needs of the public service will be met. There is also a lack of understanding of the resourcing practices used and a desire by members of the category for more information on opportunities for advancement at the departmental and service-wide levels.

17.126 Sound practices related to hiring, human resource planning, training, and career development are among the important elements needed to achieve high quality management in any organization.

17.127 When the plans to create a Management Category were announced in 1980, the objectives encompassed a number of human resource initiatives to address known weaknesses in these areas. Objectives included a planned and integrated approach to resourcing with an emphasis on more rigorous selection criteria and practices, improved human resource and career planning, and increased deputy head flexibility in the use and redeployment of the management team. An amendment to the Public Service Employment Act was anticipated that would have allowed for appointment to level.

17.128 An appointment to level implies that an individual's level is not based strictly on the level of the position he or she occupies but rather on his or her ability to function at a certain level. The person can thus be assigned to any duties for a specific period as determined by the deputy head.

Staffing Practices

17.129 A number of resourcing-related policies and practices have been implemented to provide more flexibility to the deputy heads in managing Management Category personnel. Departmental managers at senior levels viewed the increased flexibility very favourably.

17.130 However, a number of policies, systems and practices also intended to form an integral part of Management Category resourcing practices and support the flexibility of the deputy head are not in place. For example, appointment to level has not been implemented.

17.131 Instead, under the terms of the Management Category Exclusion Approval Order, deputy heads have been delegated authority from the Public Service Commission to move or redeploy Management Category personnel to any position, independent of the level of the position, provided that the employee's classification level remains unchanged and provided the employee concurs with the move. Although the Management Category Exclusion Approval Order provides a certain amount of flexibility, it is less than would be provided by appointment to level. However, the Public Service Commission has examined the implications of appointment to level and has some reservations about its viability in the public service.

17.132 The flexibility to deploy Management Category personnel provided under the terms of the Management Category Exclusion Approval Order can be used for a variety of purposes including meeting operational requirements, developing staff, temporary handling of performance problems, etc. Deputy heads are using this delegated authority. In 1986, redeployments accounted for about 30 per cent of all Management Category appointments.

17.133 The Public Service Commission has the exclusive authority for all other appointments including initial appointments, promotions, and transfers between departments. A highly service-oriented approach to Management Category staffing matters by the Public Service Commission provides deputy heads with influence and flexibility in these centrally controlled appointments.

17.134 Our review of a sample of staffing files indicated that in more than 61 per cent of the cases involving intra-and inter-departmental promotions, the person promoted was identified or among those identified by departments in documentation forwarded to the Public Service Commission. This influence was particularly strong in departmental promotions which accounted for 48.2 per cent of all Management Category appointments in 1986.

17.135 Staffing of Management Category positions is a relatively closed departmental-driven process designed to respond to management needs. There is no requirement to announce Management Category appointments made by the deputy head under delegated authority, to advertise, or to inform members of the Management Category of vacant positions or of the processes used to staff vacant positions. In 1986, according to the Public Service

Commission, 27 per cent of all Management Category promotions were not subject to a competitive process.

17.136 Questionnaire results indicated that the major concerns of respondents were the lack of information on job opportunities and, at the Senior Management level, concerns with the perceived application of merit in promotions. Of all respondents, 61 per cent (65 per cent at the SM level) were dissatisfied with information on Management Category vacancies; 14 per cent were satisfied. At the Senior Management level, 40 per cent were dissatisfied with the application of merit in selection for Management Category positions; 29 per cent were satisfied. This contrasts with the 14 per cent dissatisfied and the 60 per cent satisfied at the most senior levels. All others were neutral.

17.137 The Public Service Commission is aware of these concerns and, at the conclusion of our audit, was discussing some initiatives in this regard.

Human Resource Planning and Related Activities

17.138 Departmental human resource planning practices ranged from sophisticated succession and career planning processes to what appears to be reactive approaches to staffing Management Category positions. In some departments, there is no assurance that Management Category staffing decisions are based on a planned strategy that reflects consideration of a range of qualified candidates as originally intended when the Management Category was set up.

17.139 Where it did exist, planning was often carried out by the most senior levels in the department and primarily focused on succession planning and career development for "high flyers". In many instances, little attention appeared to be directed toward reviewing the career interests of the majority of the Management Category personnel with a view to providing them with opportunities for "job revitalization" through appointment to other positions in the department or other departments.

17.140 Fifty per cent of respondents at the Executive 3 level, 75 per cent at the Executive 2 level, and 85 per cent at the Executive 1 level claimed they did not participate in departmental succession or career planning exercises for the Management Category. That there is an absence of a planned approach to resourcing appears to be supported by questionnaire results. Of those who staffed positions in the Management Category, 21 per cent claimed that succession planning was the source of identifying the successful candidate, while 41 per cent indicated that they identified the successful candidate through their personal network. According to questionnaire results, referrals and inventory searches by the Public Service Commission accounted for 18 per cent of the successful candidates.

17.141 Because there is no service-wide planning framework or articulated resourcing strategy, there is no assurance that deputy head decisions about planned development and other resourcing matters regarding senior staff in departments are consistent with the needs of the public service as a whole.

17.142 Although deputy ministers and assistant deputy ministers are supportive of their annual meetings with the Public Service Commission to discuss Management Category career plans, there is no evidence that this information is used to develop an articulated service-wide strategy to meet the overall needs of the public service. Given the fact that close to 50 per cent of questionnaire respondents expressed intentions of leaving or retiring from the public service within 10 years, some further analysis is required. If the percentage is an accurate reflection of the reality, resourcing strategies need to be developed.

17.143 With the exception of the assistant deputy minister and equivalent level, Personnel Administrators and, to a more limited extent, Financial Officers, we did not find any service-wide, short-or long-term planning or planned development activities, nor did we find evidence of a framework within which such activities would occur.

17.144 Management Category personnel expressed concern about the perceived lack of interest that their superiors have in their careers. Questionnaire results indicated that 52 per cent of all respondents were dissatisfied with information from their superiors about departmental plans concerning their careers; 22 per cent were satisfied. At the Senior Management level, 58 per cent were dissatisfied; 17 per cent were satisfied. All others were neutral.

17.145 Although the deputy head has primary responsibility for providing counselling services, little emphasis was placed on Management Category counselling in departments. Further, the Public Service Commission has not carried out the full range of career information and counselling services that were communicated to Management Category members. For example, counselling has not been made available to members of the Category in regions outside the National Capital Region.

The Effects of Resourcing Practices

17.146 The difference between stated intent and current Management Category resourcing practices has resulted in a lack of clear understanding and knowledge on the part of Management Category members concerning the status of Management Category resourcing policies and practices. The considerable difference between what was announced and what exists reflects on the credibility of many Management Category programs. The greatest amount of concern exists at the lower levels of the Management Category.

17.147 The perceived lack of attention of senior management to the careers of Management Category subordinates has led some to believe that no one is looking after interests of the Management Category. This perception combined with the fact that staffing processes for Management Category positions are "closed" and not visible to many Management Category members and that many of the original objectives have not been fulfilled, has resulted in a relatively high level of dissatisfaction at the Executive 3 level and below. Survey results revealed a perception on the part of Management Category members that they are not being treated as valued resources consistent with their contribution; they also perceive that merit is not being applied.

17.148 The fact that assistant deputy ministers and their equivalents were satisfied with many aspects of these practices may be partly attributable to the fact that the career and succession planning that exists centrally is focused on them. Or it may be that they are more knowledgeable about the processes being used.

17.149 The extent of current formal authority and influence of the deputy head on Management Category staffing decisions raises the question of the extent to which more staffing authority could be delegated to departments. The possibility of extending authority to departments that have good human resource and career planning systems in place was foreseen when the Management Category was introduced. Doing so could have a significant impact on reducing time taken to staff some Management Category positions and could increase departmental accountability for Management Category appointments.

17.150 **Management Category resourcing practices should ensure that the needs of the public service are met, taking into account the career interests and aspirations of members in a manner consistent with a resourcing policy that provides for a better knowledge and understanding of the processes used for staffing Management Category positions, increased information about appointments at the departmental level and, where warranted, opportunities for expressing interest in positions to be filled.**

Accountability for the Management Category

The accountability framework for managing the Management Category is weakened by the division of roles and responsibilities. The lack of visible leadership, focal point, and of a forum for resolving problems makes it difficult to have an integrated and co-ordinated approach to managing the Management Category and the related human resource policies and programs.

Roles and Responsibilities

17.151 Roles and responsibilities for Management Category matters are divided between the Treasury Board Secretariat and the Public Service Commission through a system of primary, delegated and shared responsibilities. The problem is made more complex by an intricate series of formal and informal relationships and committee structures.

17.152 We found no signed agreement between Treasury Board Secretariat and the Public Service Commission on roles and responsibilities in the management of the Management Category, despite the fact that the Public Service Commission, in Part III of its Estimates, informed Parliament as early as 1983-84 that an agreement with the Treasury Board on the management of the Management Category would be signed. A statement of roles and responsibilities has recently been developed as a result of intervention by the Privy Council Office. This statement is a step in the right direction and clarifies the overall responsibilities of the Public Service Commission and the Treasury Board Secretariat. However, it is not explicit in such areas as human resource planning, succession and career planning and training for the Management Category and therefore may lead to conflicting interpretations. We acknowledge the value of a formal agreement between the central agencies, but the effectiveness of such an agreement can be influenced by whether the heads of the agencies entering into it stay in their position. In our opinion, such an agreement does not provide the same assurance as a formal change in legislation.

17.153 The division of roles and responsibilities leads to a lack of visible leadership. For example, while the Treasury Board has overall responsibility for human resource planning, it is the Public Service Commission and not the Treasury Board Secretariat that sits annually with deputy and assistant deputy ministers in departments and agencies to discuss succession and career plans. Similarly, the Public Service Commission reports to Parliament on many Treasury Board programs such as the Career Assignment Program and Interchange Canada.

17.154 The division of roles and responsibilities raises the issue of potential conflicts of interest for the Public Service Commission. Under the terms of the Public Service Employment Act, the Public Service Commission has to report to Parliament on how appointments exempted from certain requirements of the Act are made. It is difficult to see how the Public Service Commission can fulfil its responsibility objectively since it is a major user of the Management Category Exclusion Approval Order.

17.155 Because roles and responsibilities are divided, there is no focal point or forum for discussing or resolving Management Category matters in a co-ordinated and integrated fashion. However, there are regular meetings between central agencies to discuss matters of mutual interest. When the Management Category was set up, consideration was given to establishing an interdepartmental committee to allow for input from members and discussion of Management Category matters. Such a committee has never been fully operational.

17.156 The lack of a forum hinders an integrated approach to managing the Management Category. For example, we have been informed by the Treasury Board Secretariat that it does not consult with the Public Service Commission or departments on proposed recommendations to the Advisory Group on Executive Compensation or Treasury Board regarding Management Category compensation since this is clearly a Treasury Board responsibility. Although this is true, the Public Service Commission and departments might have useful and current information on how proposed changes in the compensation policy for the Management Category may affect their ability to attract and recruit candidates to certain positions. This could prove valuable information to the Secretariat. Similarly, issues such as the extent to which the Management Category constitutes a corporate versus a departmental resource cannot be resolved without other central agencies and departments being involved. These Management Category issues cannot be addressed in a unilateral and piecemeal fashion by one central agency or another. They require strong leadership and direction from the centre and consensus among departments and central agencies.

17.157 The Committee of Senior Officials, under the leadership of the Clerk of the Privy Council, has recently initiated a review of Management Category programs by central agencies. Some senior personnel have questioned the ability of the Committee of Senior Officials to perform co-ordinating functions of this nature at the level of detail sometimes required because of its other responsibilities.

Accountability for Results

17.158 Because of the division of roles and responsibilities, there is no overall accountability for Management Category programs. Even in areas where roles and responsibilities are defined, there is little or no accounting for results achieved.

17.159 For example, despite the specific requirements of the policy set to control the number of senior personnel in the public service, Treasury Board Secretariat does not report annually to the Treasury Board Ministers on the number of senior personnel in the public service or on the implementation and administration of the policy. There is no periodic accounting by the Treasury Board Secretariat to the Ministers for Management Category matters despite the fact that some activities, such as the conversion to the Management Category and the Management Orientation programs, have cost taxpayers millions of dollars. Our review of Part III of the Treasury Board Secretariat's Estimates from 1982 to 1987 revealed that there has been no information or accounting to Parliament on the progress made in implementing the various Management Category policies and programs.

17.160 The Public Service Commission does not report to Parliament on staffing matters delegated to deputy heads under the Management Category Exclusion Approval Order in a manner that meets all the requirements of section 45 of the Public Service Employment Act.

17.161 In the few areas where deputy heads have delegated authority, they are not held to account because the central agencies have few procedures in place to review or audit departmental practices. For example, because of deficiencies in review mechanisms at the departmental level, the Treasury Board Secretariat is not in a position to account to the government for delegated Management Category matters such as the implementation of current policies and practices regarding the number of senior personnel, performance review and employee appraisal, counselling and training, etc.

17.162 Although the Public Service Commission is aware of the number of redeployments in departments, it does not periodically review departmental practices to determine whether the use of deployment for such matters as resolving performance problems temporarily or enhancing development meets original intentions. We found that some departments were using deployment to a high degree to deal with performance problems. This may be a reflection of inadequacies in other human resource policies (training for example) or in the management of such cases.

17.163 In 1986 the Public Service Commission told the Public Accounts Committee of its intent to monitor redeployment appointments carried out by deputy heads. However, as of 1 June 1987, redeployment authority had not yet been subject to a periodic, systematic review. This weakness was previously noted in a 1984 Public Service Commission internal audit report and in our 1985 audit of the Public Service Commission.

17.164 When the Management Category was created, it was clearly communicated to members that there would be improved human resource and career planning practices to ensure high quality management and to support the greater authority and flexibility given to the deputy head. We found that there were no processes in Treasury Board Secretariat or the Public Service Commission to review progress systematically in these areas. As a result, central agencies are not in a position to determine the extent to which departmental Management Category staffing or development decisions are based on an approach to resourcing that reflects service-wide resourcing strategies.

17.165 In our opinion, the roles and responsibilities with regard to the management of the Management Category are too diffused and complex to ensure an effective and integrated approach to human resource management for this group. This situation also leads to weaknesses in accountability for matters related to this critical resource.

17.166 Finally, the current division of roles and responsibilities reinforces the perception that nobody is in charge and that not enough attention is given to managing management personnel. It contributes to the perception of Management Category members, particularly at the lower levels, that there is little concern for resolving what they consider constraints to a more effective and efficient public service.

17.167 **Treasury Board should ensure that the allocation of roles and responsibilities for Management Category programs provides for clear leadership and direction, a planned and co-ordinated approach to the management of the Management Category, and an appropriate accounting for results.**

Conclusions

17.168 In our opinion, the various announcements made at the time the Management Category was set up constituted a "blueprint for action".

17.169 Despite problems with definition and composition, more of the managerial cadre has now been more clearly identified through grouping under a common Position Evaluation Plan. Deputy heads have been provided with authority to redeploy senior personnel, and they have a more flexible approach for staffing Management Category positions. Mandatory orientation training has also been introduced and implemented. Some progress has been made with regard to performance management such as the re-introduction of pay for performance.

17.170 However, many of the anticipated or announced changes have not occurred. This has resulted in cynicism and disillusionment and brings into question the degree of commitment of the government and central agencies to achieving the announced objectives.

17.171 Deputy head authority is still greatly constrained by central agencies. Deputies have no authority to classify Management Category positions and, despite the fact that most of the Management Category appointments take place within departments, deputy heads do not have formal authority to promote members of their management team. In our opinion, this is inconsistent with their responsibilities and other delegated authorities such as the authority to organize their departments up to the Executive 3 level. This is also inconsistent with the recommendations of the Lambert Royal Commission that central controls exist only for assistant deputy minister and equivalent levels.

17.172 Many Management Category members recognize the need for central controls over such matters as compensation or the number of senior personnel, but many view some of the current programs or practices to be inadequate, excessive or in need of review. They are also of the opinion that departmental track records should influence the extent to which delegation of authority should be granted. We share those views.

17.173 In our opinion, what is required from central agencies is a management role, supportive of the government, providing for leadership, setting objectives and priorities, delegating authority, monitoring and periodically accounting for results – all with appropriate rewards and sanctions.

17.174 **Taking into consideration their performance and the requirement for accountability, deputy heads should be delegated authority necessary to manage the departmental managerial cadre efficiently and effectively.**

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

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ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

"The Work of his Office"

18.1 The Auditor General Act requires the Auditor General to report annually to the House of Commons on the work of his office. That work, of course, includes all that is reported in the previous chapters of this annual Report. But, increasingly, the work of his office includes much that is not reported in the Auditor General's annual Report.

18.2 For example, the duties of the Auditor General were greatly extended by the amendments to the Financial Administration Act which created a new accountability regime for Canada's Crown corporations. However, only in exceptional cases does the Auditor General report to Parliament on this dimension of his work in his annual Report. Nor does his annual Report attempt to include all the Auditor General's work relating to the departments of government.

18.3 The preceding chapters of this Report bring to the attention of Members of Parliament only matters of major significance. Many more items of lesser importance are referred directly to departments for their consideration and for appropriate remedial action. Neither does this annual Report contain much of the results of the Auditor General's traditional auditing work in examining the financial statements of the Government of Canada. For the Auditor General's audit opinion and observations in this area, Members of Parliament must consult the Public Accounts of Canada.

18.4 All of which is to say that while this annual Report presents the results of substantial segments of the Auditor General's activities, it is by no means the sole output of his office. And when, in accordance with the provisions of Part XII of the Financial Administration Act, the Auditor General becomes auditor or joint auditor of each parent Crown corporation named in Part I of Schedule C, even more of the resources will be devoted to activities that are not directly reported to Parliament.

18.5 Increasingly, therefore, the requirement in the Auditor General Act for the Auditor General to report annually to the House of Commons on the work of his office involves two distinct activities.

18.6 First, in the body of the annual Report the Auditor General continues to report the significant audit findings arising from audit work in departments and agencies. Second, he must employ other means to inform Members of Parliament about the work that is not reported directly to them.

18.7 Happily, such a means already exists. Today, the Part III of the Estimates for the Office of the Auditor General allows the Auditor General to provide Parliament with the details about all the Office's work, whether it is reported to the House or elsewhere.

18.8 The importance of the Office's Part III of the Estimates has been enhanced by the fact that beginning with fiscal year 1987-88, the Public Accounts Committee is now the body that examines and approves, on behalf of Parliament, the Estimates for the Office of the Auditor General.

18.9 In the words of the Auditor General when he appeared before the Public Accounts Committee on 12 March 1987:

> I am pleased to be here this morning to review my Estimates with you. I think it is appropriate that this committee is now the one I appear before on my Estimates. This is the committee that reviews the culmination of my year's work - my annual Report - and therefore I believe it is appropriate that you know how I plan to put to work the money I am asking for - what my outputs are ... The most visible outputs of my Office are my annual Report to Parliament and my opinion on the financial statements of Canada. However, there are many other outputs. For example, we are required to provide separate opinions on about 100 other government entities including 40 Crown corporations. Furthermore, over a period of five years we are required to conduct special examinations in all Crown corporations for which I am the appointed auditor.
>
> This is where the money goes and is, I think, the main reason we are here today - so that I can explain in more detail where it goes and why, as well as what our programs are about.

18.10 So any Member of Parliament – or any interested citizen – can gain a very full understanding of the work, organization, finances and outputs of the Office of the Auditor General by perusing the Auditor General's annual Report, his Opinion and Observations on the Financial Statements, and the Office's Estimates Part III.

Purpose of this Chapter

18.11 Traditionally, the Auditor General has had one additional means of giving information about the work of his office – this chapter which describes the current organization and programs of the Office. This chapter also predates the Part IIIs. Like the annual reports of other departments, it at one time provided MPs with essential information about the Office's work and programs that was not available elsewhere.

18.12 However, almost all that detail is now contained in Part IIIs, leaving departmental annual reports somewhat in limbo. In the words of the Financial Management and Control Study (Chapter 4 of this Report): "Since the introduction of Part III of the Estimates, most departmental annual reports no longer serve an identifiable purpose".

18.13 One option that does remain for a departmental annual report, and specifically for this chapter, is to highlight certain activities and new initiatives that may be of particular interest to Members of Parliament and to others wishing to know more about the work of the Auditor General and his Office. This is the thrust of this chapter. Readers, however, should be cautioned that the attention given here to a particular activity does not reflect its overall importance in the Office's work. For example, little is said here about ongoing audit work; more attention is given to international activities. But, in the larger picture, the resources used for international work are minimal compared to those devoted to fulfilling the Office's essential audit mandate.

Mandate, Auditing, Reporting, Organization, Financial Resources

Mandate

18.14 The legislative mandate for the activities of the Auditor General is in the Auditor General Act, 1977, and in the Financial Administration Act and its 1984 amendments.

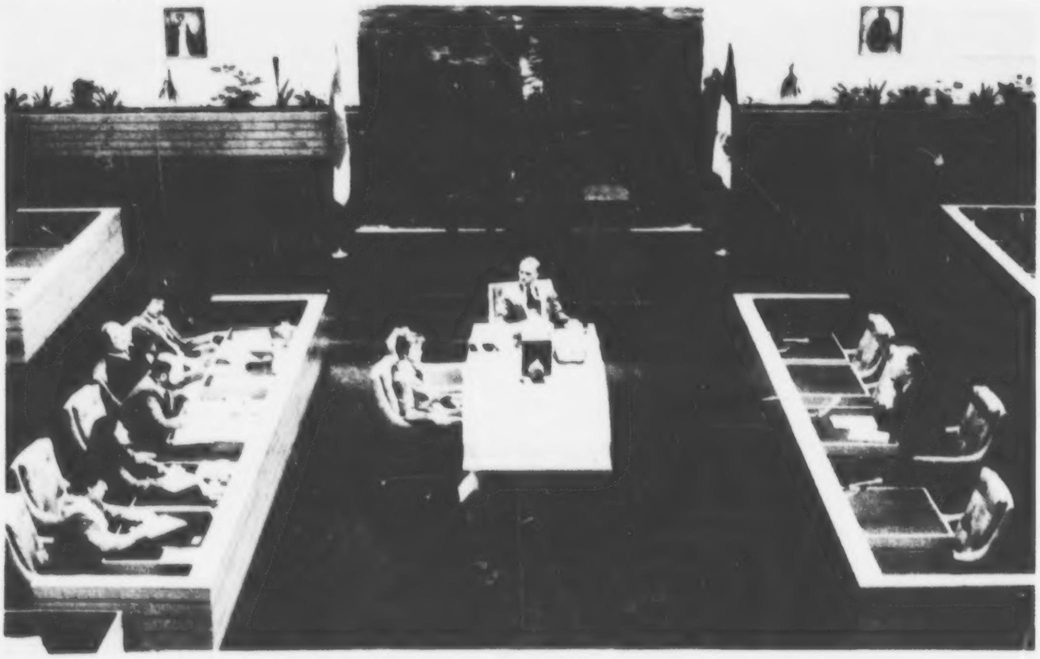
Auditing

18.15 Each year the Office conducts audits in all departments and agencies to enable the Auditor General to express an opinion on the summary financial statements of the Government of Canada. Annual audits also assess departmental and agency compliance with legislative authority.

18.16 The Auditor General also conducts value-for-money audits in departments and agencies to fulfil the reporting requirements of section 7(2) of the Auditor General Act. Cases are reported where departments or agencies have made expenditures without due regard to economy and efficiency, or where satisfactory procedures have not been established to measure and report the effectiveness of programs. The Office carries out these audits in each major government entity at least once every five years. As well, the Office conducts government-wide audits when it is feasible and appropriate to examine issues common to a number of departments.

Reporting

18.17 Throughout the audit process, findings are discussed with managers in the entities being audited. At the conclusion of an audit, a detailed report is given to the management of the audited organization on the Office's findings, conclusions and recommendations. Finally, matters that the Auditor General identifies as being of concern to Members of Parliament are brought together in the annual Report. An opinion - together with any reservations the Auditor General may have - is given on the Public Accounts of Canada and included in Volume I of the Public Accounts. Audits and special examinations in Crown corporations are reported to the board of directors of the corporation.



Kenneth M. Dye testifies before members of Yukon's Public Accounts Committee.

Organization

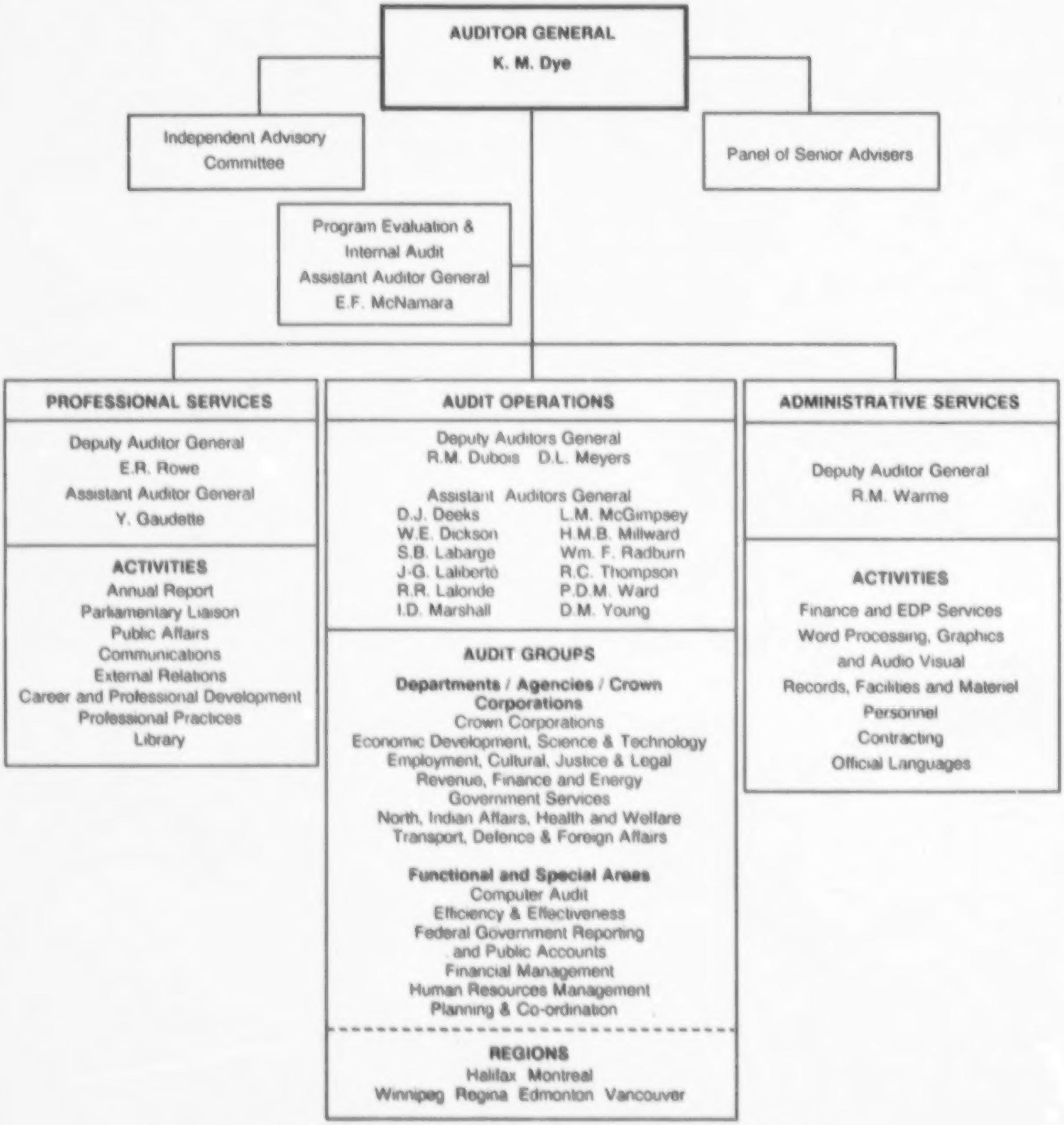
18.18 Exhibit 18.1 is an overview of the organizational structure of the Office, showing the functions of its three branches.

18.19 **Audit Operations** is the largest branch. It consists of six Department and Agency Audit groups, a Crown Corporations group, five Functional and Special Audit groups, a Planning and Co-ordination Group, and five Regional Audit groups. The six audit groups for departments and agencies are each headed by an Assistant Auditor General and each is responsible for a mix of entities that have similar requirements in terms of audit skills and special expertise or that have strong program interrelationships. The largest concentration of auditors is in the National Capital Region; in addition, Audit Operations' work is carried out from regional offices in Halifax, Montreal, Winnipeg, Regina, Edmonton and Vancouver. Personnel also work more or less continuously in Yellowknife and Whitehorse. The work of the regional offices is currently being reorganized and strengthened by the nomination of Assistant Auditors General to have responsibility for the eastern and western regions.

18.20 **Professional Services** provides professional and technical support to Audit Operations. The Branch reviews, edits and publishes the annual Report and other reports. It is also responsible for providing career and professional development and for liaison with Parliament, public relations, communications, and the Office library. The Branch co-ordinates

Exhibit 18.1

ORGANIZATION OF THE OFFICE OF THE AUDITOR GENERAL
August 1987


AUDITOR GENERAL
K. M. Dye
Independent Advisory Committee
Panel of Senior Advisers
Program Evaluation & Internal Audit
Assistant Auditor General
E.F. McNamara
PROFESSIONAL SERVICES
Deputy Auditor General
E.R. Rowe
Assistant Auditor General
Y. Gaudette
ACTIVITIES
Annual Report
Parliamentary Liaison
Public Affairs
Communications
External Relations
Career and Professional Development
Professional Practices
Library
AUDIT OPERATIONS
Deputy Auditors General
R.M. Dubois D.L. Meyers
Assistant Auditors General
D.J. Deeks L.M. McGimpsey
W.E. Dickson H.M.B. Millward
S.B. Labarge Wm. F. Radburn
J-G. Laliberté R.C. Thompson
R.R. Lalonde P.D.M. Ward
I.D. Marshall D.M. Young
AUDIT GROUPS
Departments / Agencies / Crown Corporations
Crown Corporations
Economic Development, Science & Technology
Employment, Cultural, Justice & Legal
Revenue, Finance and Energy
Government Services
North, Indian Affairs, Health and Welfare
Transport, Defence & Foreign Affairs
Functional and Special Areas
Computer Audit
Efficiency & Effectiveness
Federal Government Reporting and Public Accounts
Financial Management
Human Resources Management
Planning & Co-ordination
REGIONS
Halifax Montreal
Winnipeg Regina Edmonton Vancouver
ADMINISTRATIVE SERVICES
Deputy Auditor General
R.M. Warme
ACTIVITIES
Finance and EDP Services
Word Processing, Graphics and Audio Visual
Records, Facilities and Materiel
Personnel
Contracting
Official Languages

The Executive Committee is composed of the Auditor General and the Deputy Auditors General.

international activities and liaison with provincial Auditors General. It is responsible for professional practices, including the management of auditing methodology development.

18.21 **Administrative Services** is the Branch that provides central support in the areas of finance, personnel, contracting, official languages, records, facilities and materiel, EDP services, word processing, graphics and audio-visual services.

Financial Resources

18.22 As already indicated, Members of Parliament are now provided with the Office's detailed Resource Requirements in Part III of the Estimates. Exhibit 18.2 is an overview of appropriations and expenditures by activity and by object.

18.23 The balance of this chapter is devoted to a more detailed description of a number of activities of importance in the life of the Office of the Auditor General in the last year.

Study on the Cost Effectiveness of the Audit Work of the Office of the Auditor General

18.24 Comprehensive auditing and especially its value-for-money component have proved most valuable instruments in identifying the information about government activities that are of significance to Members of Parliament. But comprehensive auditing is a relatively new art and science. It is also costly. And while, by any measure, the comprehensive audits conducted by the Office of the Auditor General over the last decade have proved effective in identifying potential areas for improved economy and efficiency throughout the departments and agencies, the question can be asked whether the Office itself cannot fulfil its essential mandate at less cost. With the benefit of experience, can its auditing not be done with increasing effectiveness and reduced resources?

18.25 The present Auditor General has responded to this challenge in a variety of ways. Readers of this chapter in previous annual Reports will recall that there are two reasons that the Office finds itself at the cutting-edge of electronic audit technology. First, these skills are needed to audit the departments and agencies of government whose own financial, management and program information is increasingly stored electronically. However, the second reason is that this audit technology allows the Office to do its work better, faster and more economically. New electronic initiatives in 1986-87 are described in the next section of this chapter.

18.26 Readers will also recall that this chapter in last year's Report contained a full discussion of the Office's successful effort to find more cost-effective ways of performing the financial and authorities audits required under the Auditor General's mandate.

18.27 It was logical therefore to extend this examination of cost effectiveness to the whole range of audits the Office performs. This compelling piece of work has been undertaken

Exhibit 18.2

OFFICE OF THE AUDITOR GENERAL OF CANADA
APPROPRIATIONS AND EXPENDITURES

Appropriations and Expenditures by Actitivy

	1987-88	1986-87		1985-86	
	Estimates	Appropriations	Expenditures (thousands of dollars)	Appropriations	Expenditures
Legislative Auditing	46,686	44,982	44,210	43,390	42,433
TOTAL	46,686	44,982	44,210	43,390	42,433

Appropriations and Expenditures by Object

	1987-88	1986-87		1985-86	
	Estimates	Appropriations	Expenditures (thousands of dollars)	Appropriations	Expenditures
Salaries and Wages	29,907	28,663	26,489	27,753	26,381
Contributions to Employee Benefit Plans	4,412	4,377	4,377	4,212	4,212
Transportation and Communications	2,918	2,918	2,945	2,525	2,956
Information	273	273	277	106	299
Professional and Special Services	6,659	6,960	7,062	7,112	6,185
Rentals	262	262	334	238	284
Purchased Repair and Upkeep	296	296	376	103	223
Utilities, Materials and Supplies	350	350	636	471	429
Capital-Construction or Acquisition of Machinery and Equipment	1,149	438	1,268	450	1,042
Transfer Payments	450	435	434	410	410
All Other Expenditures	10	10	12	10	12
TOTAL	46,686	44,982	44,210	43,390	42,433

by the Stevenson Kellogg Ernst & Whinney, Management Consultants, under the direction of Kenneth G. Belbeck, together with members of the Auditor General's senior staff. The report and recommendations of the study were to be available in September 1987 shortly after this Report went to press.

Background

18.28 This Office now has some 10 years of solid experience with the concept of comprehensive auditing. Over the decade there has been active development in methodology, techniques and training in the Auditor General's Office and in the other professional organizations involved with auditing in the public sector. The time has come to take inventory. There is a growing realization that value-for-money auditing is an expensive business. An audit in a major department or agency can cost upwards of a million dollars. Unlike financial auditing, there are no generally accepted auditing standards or criteria to be used consistently in every audit. The Canadian Institute of Chartered Accountants is working on this problem. However, there are some who believe that each audit is so unique that only very general standards can be developed. At best the creating of standards must be evolutionary and gradual, and it is still in the earliest stage of development. Nonetheless it is extremely important that all audit organizations involved in comprehensive auditing, and more particularly the Office of the Auditor General, periodically assess the cost effectiveness of audit work. The comprehensive audit concept will survive only if its cost effectiveness is readily apparent.

18.29 The special project on cost effectiveness began in December 1986. The purpose of the project is to improve the general performance of the Office, which has provided leadership in comprehensive and legislative auditing. The cost effectiveness project should provide project insights into areas that may need further improvement.

18.30 The scope of the project includes mainly the activities of the Audit Operations Branch and the activities in other branches that directly affect audit work. These include Career and Professional Development, Professional Practices, and Program Evaluation and Internal Audit.

Three Phases of the Project

18.31 The project has involved three main phases. The first two were of a diagnostic nature. The third was designed to gather information to develop recommendations for further improvement in areas identified by the study.

18.32 **Phase I** had two components. The first dealt with the Audit Philosophy, Policy and Goals of the Office. It provided an important reference for the rest of the project. The objective was to identify issues at the audit policy level that are perceived by our own senior managers as not fully resolved. The second component was an employee survey of attitudes and values across the Office. Its purpose was to solicit the views of all staff on a wide variety of subjects, such as job satisfaction, communications, management and working conditions. This exercise helped identify for senior management matters requiring attention and related opportunities to be explored during the rest of the project.

Members of the team conducting the Study on Cost Effectiveness.

18.33 **Phase II** had three components. The first was most critical. It involved an independent review by Stevenson Kellogg Ernst & Whinney of a sample of recent audits in support of the Office's annual work on the Public Accounts, financial statement audits of Crown corporations and periodic value-for-money audits of departments and agencies. The second component of this phase involved examining the roles and relationships of functional groups with our line audit staff. This part of the project looked at the contribution functional groups make to the quality of audit work in relation to cost. The third component was a study of the annual reporting process. The annual Report is the Auditor General's most visible product. The special project provides feedback on the efficiency and effectiveness of the process the Office uses to review and present our audit findings.

18.34 **Phase III** of the project dealt with cause and effect relationships necessary to develop sound recommendations in areas identified for improvement by the study. This phase involved a careful examination of the career and professional development program which consumes six per cent of the Office's resources. The performance review and termination process and other significant human resource planning areas were also addressed. The objective of this phase was to identify how well the Office manages its key asset: people.

18.35 The third area for examination in this phase went to the heart of the corporate audit planning process in the Auditor General's Office. Included in the examination was strategic and operational planning including the process for setting priorities for audit work carried out in a range of departments and agencies, big and small. The main objective was to look at ways and means by which we could continue to audit matters that are of most significance to Parliament and to search for opportunities that will allow the Office to meet its expanding obligations in areas such as special examinations of Crown corporations without requiring a real increase in budget. This final phase also examined how the Office is organized and how it delivers its main products – the results of its attest, authority and value-for-money audits. Particular attention was directed to the setting of goals and direction for audit staff, to the management style of senior personnel, administration of audit teams, the size and nature of departmental teams, and the function and the reporting relationship of regional offices.

Overall Benefit

18.36 Although the results of the cost effectiveness study had not been finalized when this Report went to press, the Auditor General has expressed his confident view that the study will assist him in his ongoing commitment to achieve maximum economy, efficiency and effectiveness in fulfilling the mandate of his Office.

Information Technology and the Office of the Auditor General

18.37 Electronic data processing is having an enormous impact in our age. Because governments are largely in the business of information, advances in information technology are proving particularly important in all federal government activities. In its broader implication, this issue is touched on in Chapter 1 of this Report.

18.38 It is becoming apparent that the profession of accounting and auditing has been dramatically affected by the new developments in electronic technology. Accountants and auditors operate in a world of financial analysis and computation where virtually all financial records are now kept electronically.

18.39 The Office of the Auditor General has responded to the challenge of these new techniques and today is among the leaders in those employing electronic information technology in auditing.

18.40 Parallel progress has occurred in the use of new technology in the non-audit aspects of the Office's activities, especially in the area of improved communications.

Information Technology in Auditing

18.41 In 1985-86 the Office launched its three-year special EDP initiative. A major element was training the Office's auditors in computer auditing. The first two years of the initiative have more than fulfilled expectations, and the newest aspects of information technology are permeating all facets of our auditing. Each audit group now has at least one graduate from the Office's apprenticeship program which has up to 10 auditors spending a full year working in the Computer Audit group.

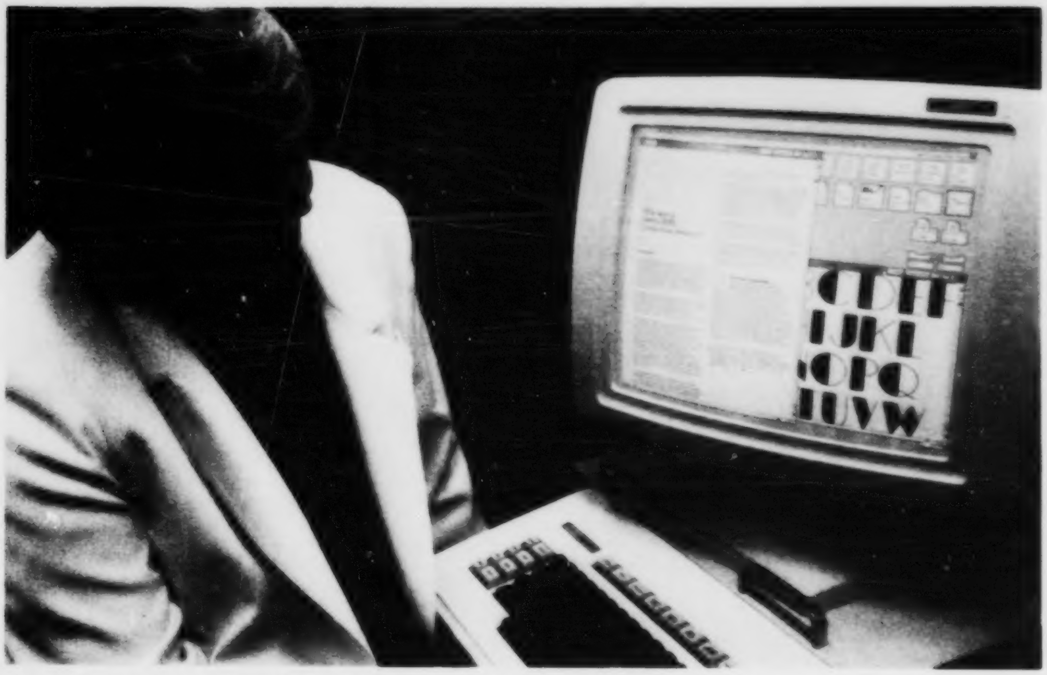
The Office is in the forefront of audit technology innovation.

18.42 IDEA, the interactive software for microcomputers developed by the Office placed the Auditor General's Office in the forefront of audit technology innovation. IDEA is now used worldwide. It is being used in over 60 audits that the Office is conducting now.

18.43 Central Data Selection, another development of the Office, is a very large system that reads, balances and statistically samples every financial transaction underlying the Public Accounts of Canada. Because of the volume (some 52 million transactions each year) Central Data Selection is run continuously throughout the year generating samples, statistics, reports and data for down-loading to microcomputers for use with IDEA.

18.44 By combining mainframe and microcomputer technology in this way, the Office has been able to improve substantially the ease and efficiency with which auditors can query government financial records, while keeping costs the same.

18.45 Meanwhile the Office has moved increasingly into the use of the laptop computer which allows auditors to use this new technology on location in audited organizations and on travel assignments.



State-of-the-art word and graphic systems are used to produce the annual Report.

Toward the Office of the Future

18.46 Hand in hand with using electronic information processing for its audit work, the Office has been harnessing this technology to improve its internal capabilities. State-of-the-art word and information systems are used throughout the production phases of this Report. And today's software permits the Office to produce and integrate sophisticated flow charts, organization charts, data flow diagrams, presentation graphics and specialized text.

18.47 Good communications are a vital element in the work of the Office of the Auditor General. Its major product is the annual Report, and internal communications as well as communications with audited organizations are the key to the success of that endeavour. In the past year, the Office has significantly improved its ability to communicate through electronic means.

18.48 The first local area network dedicated to the use of an audit team was set up in the fall of 1986. The network provides a short-distance link between computers and improves the efficiency of automated tools by making them simpler to use.

18.49 Electronic mail has been another development. This service is available from any computer with a modem and is linked to communications systems that allow messages to be received throughout the world.

The China project has provided an attractive dimension to the life and culture of the Office.

18.50 A graphics text software package that can be used on a personal computer to create images and text for presentations is another form of communication used by auditors. This is quickly becoming the Office standard for effective presentations.

The International Scene

18.51 Because the Office of the Auditor General of Canada has been a pioneer in comprehensive auditing and legislative auditing, its skills and experience are in demand throughout the world, especially by developing nations and in other countries establishing or strengthening their own abilities in governmental auditing.

18.52 **The International Audit Office Assistance Program.** Announced in the United Nations in autumn 1979, this program is designed to help auditors from developing nations upgrade their public sector auditing skills and techniques, especially through the practice of value-for-money auditing. The program is a Canadian initiative, funded by the Canadian International Development Agency (CIDA) and administered by the Canadian Comprehensive Auditing Foundation. There is a training component and a fellowship program. Fellows in 1986-87 were from Colombia, Gambia, India, Malaysia, Morocco, Pakistan, People's Republic of China, and Tanzania. They were joined by two Fellows sponsored by the Audit Office of Saudi Arabia. During their year, the Fellows add an interesting dimension to the life of the Office, assisting in a variety of audit areas. More important, on returning to their own countries, they apply the formal training and on-the-job experience to their home situations where they continue to be guided by visits from Canadian advisers. Former fellows are today making significant contributions to auditing in nations around the world.

18.53 St. Lucia benefited from the legislative auditing training project started last year and continuing into 1986-87. Classroom training was supplemented by on-the-job training provided throughout the comprehensive audit of the Island's Department of Customs and Excise – the first comprehensive audit to be carried out exclusively by St. Lucia's own audit staff. Funded by CIDA, the Office's involvement in St. Lucia has contributed to a greatly strengthened audit function for that young, self-governing nation.

18.54 Under the auspices of the United Nations, the Office is sharing its knowledge and skills with the Office of the Auditor General of Cyprus. The objective is to foster the development of performance audit in the Republic of Cyprus.

18.55 Three other international projects were of special significance in 1986-87: The Sino-Canadian auditing training project; the INTOSAI development initiative; the review of the audit system at NATO.

18.56 **The Sino-Canadian Auditing Training Project**. Since 1982, the Office has been involved in an international effort with CIDA, the United Nations and the People's Republic of China to assist the Peoples' Republic in developing the legislative audit function called for in its new constitution.

18.57 Eventually the Chinese Audit Office will have some 40,000 staff auditors. With that number – and 100,000 internal auditors in various audited organizations across the vast country – training is essential. The Canadian Audit Office's role has been to undertake the task of training those who will train the Chinese auditors. This focus on training audit teachers ensures the most efficient use of limited Canadian resources. The objective of this approach is to develop a core of qualified audit teachers and to provide them with the necessary professional, technical, and administrative support to help establish an appropriate training capability in the Audit Administration of the People's Republic of China. The project has five components: teacher training, audio-visual training, professional and technical support, administrative support, and project management.

18.58 This project has provided an attractive dimension to the life and culture of the Office of the Auditor General. A number of staff members – including senior auditors – have now visited China. The six-day Chinese work week is long, but the experience of living and working in such a different environment is at once rewarding and stimulating. The project has also brought a steady stream of scholars and prospective trainers from China to the Canadian Audit Office. The whole enterprise is serving as a text book illustration of a creative, co-operative program between two nations.

18.59 **The INTOSAI Development Initiative**. The idea of international training for auditors has emerged a number of times in recent years. For example, the concept of an

The International Development Initiative is making solid progress.

international centre for public accounting and auditing surfaced in 1980 at the United Nations. But although a majority of member nations supported the idea, the United Nations Secretary General could not raise sufficient funds for the project.

18.60 In March 1985, at a meeting of the Governing Board of the International Organization of Supreme Audit Institutions (INTOSAI), the Auditor General of Canada proposed that INTOSAI take on the development and implementation of what has come to be called the INTOSAI Development Initiative (IDI). The idea was that the project would be operated within the organizational structure of INTOSAI, without the "bricks and mortars" envisaged in the United Nations proposal, and funded mainly by international development organizations and national aid agencies, together with the co-operation and contributions of the national audit offices of donor countries.

18.61 At INTOSAI's twelfth congress held in Sydney, Australia, in April 1986, the proposal for the formal establishment of IDI was adopted " ... to foster the advancement of public accounting and auditing, especially in developing nations, through information exchange and training for audit practitioners and trainers of SAIs." It was also decided that during the start-up period IDI Secretariat would be attached to the Office of the Auditor General of Canada. The United States General Accounting Office has provided very significant support throughout the initial stages of IDI.

The Office of the Auditor General was a key player in a review of the NATO Audit System.

18.62 Much has been accomplished since the adoption of the IDI proposal. A small Secretariat of two permanent staff is supported by professionals seconded to it by member SAIs for short-term IDI projects. Thus the Secretariat remains small, overhead costs are kept to a minimum and SAIs have the opportunity to participate in IDI projects. The Board of Directors of IDI is advised by an Advisory Committee which consists of SAIs from 13 countries.

18.63 The work of IDI is proceeding on three fronts: the completion of a regional needs assessment, the dissemination of information through different publications including the International Directory and Audit Training Information, and offering workshops, seminars and other forms of training assistance.

18.64 **Review of the North Atlantic Treaty Organization (NATO) Audit System.** During the summer of 1986, the Office of the Auditor General of Canada was a key player in a major review of the NATO Audit System. Together with representatives from the audit offices of West Germany, Denmark, the United Kingdom and the United States, the Deputy Auditor responsible for Professional Services and the Principal in charge of Professional Practices participated in the review. Its overall objective was to ascertain where the NATO Audit System could be improved. Significant inadequacies identified by the review are being addressed.

18.65 Also on the international scene, the Office of the Auditor General of Canada continues as external auditor of the International Civil Aviation Organization. This audit is conducted from the regional office in Montreal.

"Sed Quis Custodiet Ipsos Custodes"

18.66 Juvenal's question as to who guards the guards themselves is eminently relevant to the Office of the Auditor General. If the Auditor General is the 'watchdog over the public purse', who watches the watchdog?

18.67 There is a three part answer. First, the Audit Office is externally audited. Second, it is subject to extensive internal audit, program review and evaluation. Third, periodic additional evaluating of its work is undertaken.

External Auditors

18.68 **Financial Audit.** Section 22 of the Auditor General Act provides that the Treasury Board shall nominate a qualified auditor to examine the receipts and disbursements of the Office of the Auditor General. Each audit report is to be submitted annually to the President of the Treasury Board on or before 31 December, and the President of the Treasury Board shall table the audit report in the House of Commons within 15 days after receipt. In October 1979, the Treasury Board approved the appointment of the associated firms of George A. Welch Company and Levesque, Marchand, Boulanger et Cie, as auditors of the Office of the Auditor General for a five-year period which started with the 1978-79 fiscal year. The appointment has been renewed for one-year periods since 1984.

18.69 At the time of this Report going to press, the audit report and management letter for 1986-87 had not been received. In the three previous years the auditors have given the Office a clean bill of health for all its financial activities including the Office's system of internal controls.

18.70 **Commissioner of Official Languages.** The Commissioner reports annually to Parliament on his assessment of the performance of government departments and agencies in applying the provisions of the Official Languages Act. Page 74 of the 1986 report refers to the Office of the Auditor General.

18.71 In July 1987 the Executive Committee approved a comprehensive Official Languages Plan primarily designed to respond to the Office's internal evaluation of its ongoing responsibilities in regard to Canada's two official languages. The plan also addresses issues raised by the Commissioner.

18.72 **Public Service Commission - Staffing.** Section 15(1) of the Auditor General Act specifies that all employees of the Office shall be appointed in accordance with the Public Service Employment Act. Section 15(3) also specifies that the Auditor General may exercise and perform the powers, duties and functions of the Public Service Commission, other than appeals under sections 21 and 31 and inquiries under section 32 of the Public Service Employment Act, in such a manner and subject to such terms and conditions as the Public Service Commission directs. To describe and clarify the terms and conditions under which staffing will be carried out in the Office, both parties agreed to a letter of understanding on the terms and conditions of staffing in the Auditor General's Office. The current agreement, effective February 1986, is to be reviewed and amended, if necessary, every two years at the anniversary date. One of the terms and conditions agreed to in the letter of understanding is that "the Public Service Commission will conduct on a mutually agreed basis, an audit of staffing in the Office as well as a follow-up to the audit to ensure that merit and current policies are being followed and that corrective actions have been taken if and where required". The Commission conducted its most recent audit in January 1986.

Program Evaluation and Internal Audit

18.73 This group has three ongoing objectives. Through program evaluation, it attempts to assess the effectiveness with which the Office's audit activities support the scrutiny role of the House of Commons. Through post-audit quality review, it assesses whether the quality of the Office's audit work is such that only matters of significance are selected for audit, and whether these are audited in a professional and cost-effective manner. Through internal audit, it assesses whether important management practices and procedures throughout the Office reflect due regard for value for money.

18.74 Following is a summary of the work carried out by the Program Evaluation and Internal Audit group during the past year.

18.75 *Evaluation of Professional Development.* The findings and recommendations of this study were in the 1986 annual Report. During the past year the Career and Professional Development group examined the recommendations in detail and began implementing a plan of action to address them. A major initiative was the development of a proposed curriculum of courses for the different responsibility levels in the Office. This was in response not only to a recommendation of the evaluation study, but also to the findings of an Audit Operations Branch Task Force on Knowledge and Skills Requirements for auditors.

18.76 *Survey of deputy ministers.* During the year we interviewed deputy ministers, or their representatives, of the departments with chapters in the 1985 annual Report. The purpose of the survey was to obtain their views on how their departments were represented in the Report and to invite their comments on any other matters relating to the Office's work.

These specific questions were asked of the deputies:

- Did the chapter present a fair and balanced view of your organization?
- Did the chapter display an understanding of the activities areas covered?
- Did the chapter address matters that you consider significant? Were there matters of significance that, in your opinion, should have been addressed but were not?
- Were the recommendations practical and cost effective?
- Can you suggest ways in which the audit could have been of more benefit to you?

18.77 An analysis of the responses to the questions, along with related discussions, suggests that five of the seven chapters were reviewed positively by the deputies; two were not. The deputies' responses are being taken seriously. Continuing effort is being made to better our understanding of the audit entities, to maintain effective communication throughout the audit and to strive for the proper balance and tone in the chapters at their initial drafting.

Post-audit Quality Review

18.78 A post-audit quality review is carried out annually on a representative portion of the Office's audit work.

18.79 *Departmental comprehensive audits.* During the past year an assessment was made of the shift from systems-based audit approaches, which tend to focus on the deficiencies of management processes, to more program results-based audit approaches, which place more emphasis on program and results and less on administrative systems and controls.

18.80 There was some variation among the audits, but a general shift toward more results-based auditing was evident. This shift would have been even more pronounced had the methodology now being field tested been available 18 months ago.

18.81 Those audits that were most results-based were marked by certain characteristics:

- they addressed primary program objectives and not just secondary ones;
- they analysed information on program results and assessed systems and controls only when necessary to account for results shortfalls, or when information on program results was unavailable;
- they determined the cause and effect of any identified systems and controls deficiencies; and
- they examined corrective actions taken by program management.

18.82 The review of the comprehensive auditing manual now under way will consider fully the recommendations made by post-audit quality review during the past two years concerning the scope and conduct of departmental comprehensive audits.

18.83 *Crown corporations, other entities and the Public Accounts of Canada.* Last year, we developed standardized post-audit quality review assessment methods for reviewing the audits of Crown corporations, other entities and the Public Accounts. Through questionnaires, we compared audit practices to generally accepted auditing standards and to standards of the Office. An evaluation summary was then used to indicate the degree of compliance with those standards.

18.84 The review method was used on a sample of eight Crown corporations and other entities and nine Public Accounts audits. It produced useful and informative results. Quality comparisons can be made across audits and for individual audits from year to year.

18.85 The post-audit quality review examinations of this attest and authority work revealed compliance with generally accepted auditing standards and with those of the Office.

18.86 **Contracting for professional services - follow-up audit.** The findings of the original study, reported in the 1985 annual Report, recognized significant improvements in controls over contracting, but identified a number of opportunities for further improvement. This underscores the continuing need to optimize the mix of permanent staff and consultants and to ensure effective direction, control and evaluation of contracted resources.

Internal Audit

18.87 **Internal Audit of Administrative Services Branch.** The objective of this audit was to assess the reasonableness of the nature, level and costs of services provided by the Administrative Services Branch.

18.88 In our 1986 annual Report we presented our findings on the Personnel and Corporate EDP Services within the Branch. This year we are presenting our findings on our review of the Administration section, the Word and Information Systems section and the Financial Administration function.

18.89 The audit examined how the need for the various services is established and how they are delivered and controlled. Wherever feasible, we made comparisons with other legislative auditing bodies and public accounting firms, with allowances for differences in size and environment. We surveyed and interviewed users to determine their satisfaction with the services and to elicit any suggestions or comments about how they could and should be improved.

18.90 The Administration section provides the services of Records, Mail, Facilities Management, Telecommunications and Materiel Management. Our survey of users indicates a high level of satisfaction with the services provided. The major exception is with the present telecommunications system which has not performed satisfactorily in the view of those surveyed. The problems are well on the way to being overcome. As to the Materiel Management area, there is general satisfaction with the level of service, but there are some opportunities for improving operating procedures.

18.91 The Word and Information System section provides the Office with a level of service that is at least equal to that of the other departments and private sector firms we contacted. At the same time, the increased use of microcomputers within the Office has altered the pattern of workload of the section. The Office intends to undertake a study of its continuing word processing needs.

18.92 The Financial Administration function is satisfactorily managed. The role, responsibilities and authority of the financial function, as defined in the Office Financial Manual, and its organization and staffing, enable it to carry out its controllership role effectively. As well as being managed at reasonable cost, the Financial Administration function is also quite responsive to the users of its services. We made some suggestions relating to cost accounting, performance reporting and the format of Part III of the Estimates. These are being considered by Branch management.

18.93 The only part of the Administrative Services Branch yet to be audited is the Office Languages group. This will be covered in the coming year.

Additional Evaluating

18.94 **Part III of the Estimates.** As indicated earlier, the Main Estimates of the Office were referred to and reviewed by the Public Accounts Committee for the first time in 1987. The Auditor General, in commenting on this move, said: "Members were able to challenge us on a number of continuing issues – how we choose what we are going to audit in a particular year; how we determine what is of sufficient significance to report to Parliament; how we define materiality for our attest work and significance for our value-for-money auditing; above all, how we measure the cost effectiveness of our auditing and control our own expenditures... The two hearings also gave me the opportunity of letting the Committee know about our work that is not reported in the annual Report – for example, our extensive auditing in Crown corporations and our international activities. The overall thrust of the members' questions, which ranged over virtually all my Office's activities, will be most valuable as we establish priorities for the coming year. The questioning was informed and penetrating. In our answers, we attempted to match the indepth quality of the questions."

18.95 **Cost Effectiveness Study**. It would be wrong to characterize the study on cost effectiveness of audit work, described earlier in this chapter, as a comprehensive audit. Nonetheless, its searching quality has probed the programs and activities of the Office in a manner that is not dissimilar to a value-for-money audit or a special examination.

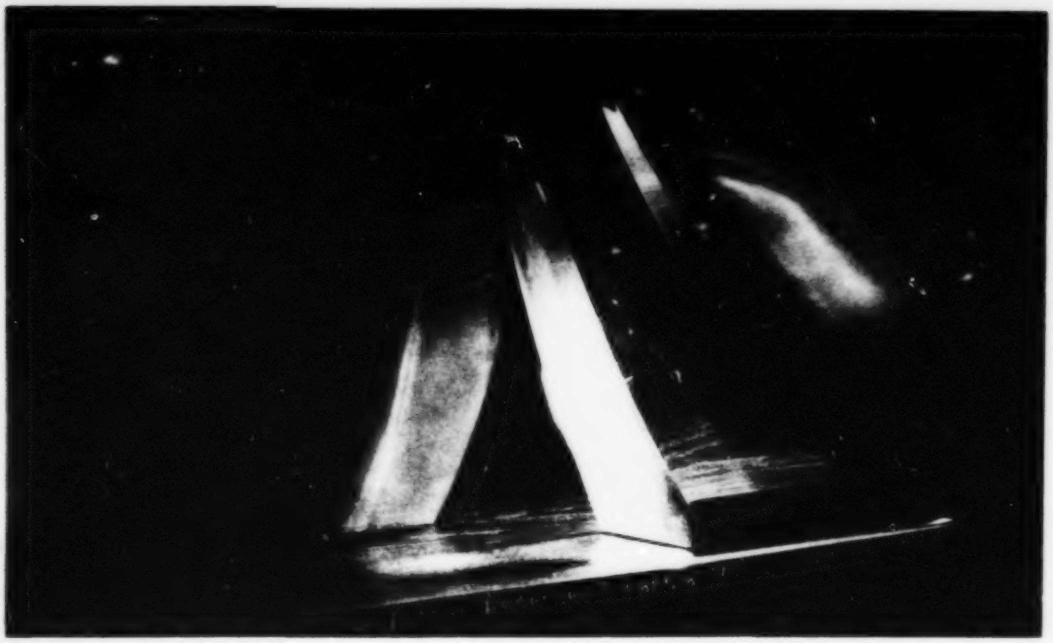
18.96 In summary, then, the Office of the Auditor General is open to high levels of scrutiny; and the one who is vigilant in examining others is vigilantly examined.

Other Initiatives

18.97 This chapter has discussed several especially noteworthy activities of the Office of the Auditor General in 1986-87. There are other matters of interest that can be reported more briefly.

Audit Office Wins International Award

18.98 In the fall of 1985, the United Kingdom's Chartered Institute of Public Finance and Accountancy (CIPFA) and Arthur Andersen & Co. Management Consultants announced the



Audit Office's Financial Management Reporting System won inaugural CIPFA - Arthur Andersen Award.

inauguration of the CIPFA-Arthur Andersen Financial Management Reports Award. Designed to foster better control of costs and achievements in the public sector, the annual competition was launched to seek the best examples of current financial management practices. The 1986 entries were expected to demonstrate how clear, regular and economically presented internal reports contribute to good financial management. Such reports were to cover not only spending but also achievements and recommendations for action.

18.99 In October 1986, at the CIPFA Conference held in Birmingham, England, Sir Roy Griffiths, chairman of the judging panel, announced that the Office of the Auditor General of Canada was the 1986 winner of the Award.

18.100 He described the Office's financial management reporting system as "well planned and well designed. The reports are timely and used as a vital part of management control .... It quite definitely illustrates management professionalism of a high order. I emphasize that reports of this standard are a pleasure to see and to use.... Congratulations to the Office of the Auditor General of Canada".

Federal Court Case

18.101 The matter of the Auditor General's free access to information in the matter of the Petrofina acquisition was brought to the Federal Court of Canada on 5 June 1984. The decision of Mr. Justice Jerome was received on 5 December 1985. Mr. Justice Jerome declared that the meaning of section 13(1) of the Auditor General Act was clear and unequivocal and that it entitled this Office to free access to all information it required to fulfil its responsibilities.

18.102 On 30 December 1985, the government announced that it would appeal the decision of Mr. Justice Jerome to the Federal Court of Appeal. The appeal was heard by three judges on 6, 7 and 8 October 1986, and a judgement was rendered on 22 January 1987. For different reasons two of the judges of the Federal Court of Appeal ruled against the Auditor General. One of the judges ruled in favour. The Auditor General then sought leave to appeal his decision to the Supreme Court of Canada. Arguments for leave to appeal were presented to the Supreme Court on 7 April 1987.

18.103 On 25 June 1987 the Supreme Court granted the Auditor General leave to appeal.

Video Presentation of the Annual Report

18.104 One of the continuing concerns of the Auditor General is to communicate effectively the results of the work of his office. An audit is valueless unless its findings are communicated. Over the last six years a great deal of attention has been given to the presentation of the annual Report - to its structure, to the clarity of the writing, to improved graphics, to the use of photographs.

18.105 A logical next step was to consider making visual presentations of the Report's main messages. A pilot project in 1986 saw the production of a 10-minute videotape of one annual Report chapter – the Veterans Affairs Portfolio. This got a positive response from the members of the Public Accounts Committee and the other Members of Parliament who saw it.

18.106 Four chapters of this Report are to be made available on video. The goal is to present the highlights of these Report Chapters in a way that will help Members of Parliament find out quickly what the audits are saying and where they can get more details. The videos are placed on the Parliamentary OASIS computer system allowing Members immediate access. The chapters taped this year are the Financial Management and Control Study (Chapter 4), the Department of National Health and Welfare (12), the Department of National Defence - Materiel Support (Chapter 10), and three of the Special Audits in Chapter 15.

Task Force on Knowledge and Skills

18.107 Over the past few years Audit Groups have reviewed their human resource complement and assessed their requirements for staff. Each Group is continuing to work toward ensuring that the Office has a sufficient number and quality of staff to continue to meet audit responsibilities. A task force was created by the Deputy Auditors General of Audit Operations in May 1985. The report of the Task Force on Knowledge and Skills was published in May 1987. It will become an important instrument in reviewing standards, promotion criteria and performance appraisals, all of which are integral to the Audit Groups human resource planning.

The
Veterans Affairs
Portfolio

Annual Report chapter highlights are available on MPs' video system.

Comprehensive Auditing Manual

18.108 Part 2 of the Office's Comprehensive Auditing Manual was issued for field testing in 1986. This part of the Manual outlines the policies, approaches and procedures applicable to auditing departments and agencies in order to fulfil the Office's responsibilities set out in the Auditor General Act, primarily sections 5, 6 and 7. Part 2 also contains certain guidelines and indicators for use by staff in carrying out specific aspects of the audit work. It was prepared with the involvement of many of the audit staff and co-ordinated by the Professional Practices group in collaboration with the Public Accounts Audit group. Successive drafts were reviewed by the Methodology Development Committee, an advisory group, and the Auditor General's Independent Advisory Committee on Government Accounting and Auditing Standards. Part 2, together with the previously issued Part 1 (outlining the Auditor General's mandate and the Office's organization, role and audit responsibilities) and Part 3 ("Crown Corporations and Other Entities"), has been approved by the Executive Committee for field testing.

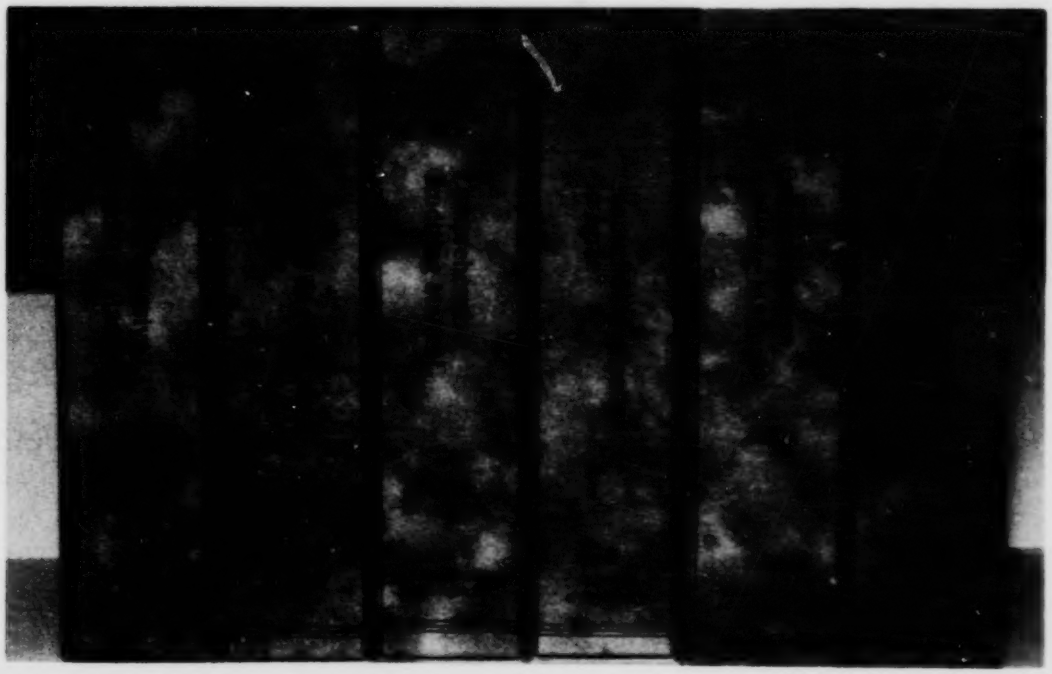
Costs Incurred in Preparing Reports of Audits and Special Examinations in Crown Corporations

18.109 Section 149(2) of Part XII of the Financial Administration Act (FAA) requires that where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred in preparing any report under sections 139 and 143 shall be disclosed in his next annual Report and be paid out of the moneys appropriated for his Office.

Exhibit 18.3

COSTS OF PREPARING ANNUAL AUDIT REPORTS FOR FISCAL YEARS ENDING ON OR BEFORE 31 MARCH 1987

Crown Corporation	Fiscal Year Ended	Cost Incurrred
Atlantic Pilotage Authority	31.12.86	$ 48,600
Atomic Energy of Canada Limited	31.03.87	347,600
Canada Deposit Insurance Corporation	31.12.86	448,300
Canada Development Investment Corporation (Joint Auditor)	31.12.86	43,600
Cartierville Financial Corporation Inc.	31.12.86	10,000
Canada Harbour Place Corporation	31.03.87	80,500
Canada Lands Company Limited	31.03.87	4,800
Canada Lands Company (Le Vieux-Port de Montréal) Limited	31.03.87	43,500
Canada Lands Company (Mirabel) Limited	31.03.87	64,500
Canada Lands Company (Vieux-Port de Quebec) Inc.	31.03.87	71,600
Canada Museums Construction Corporation Inc.	31.03.87	76,400
Canada Post Corporation (Joint Auditor)	31.03.87	319,900
Canadian Commercial Corporation	31.03.87	170,200
Canadian Dairy Commission	31.07.86	181,200
Canadian Livestock Feed Board	31.03.87	37,300
Canadian National (West Indies) Steamships Limited	31.12.86	3,200
Canadian Patents and Development Limited	31.03.87	28,400
Canadian Saltfish Corporation	31.03.87	147,600
Canagrex	31.03.87	6,100
Defence Construction (1951) Limited	31.03.87	65,100
Export Development Corporation	31.12.86	365,600
Farm Credit Corporation	31.03.87	201,500
Freshwater Fish Marketing Corporation	30.04.86	128,500
Great Lakes Pilotage Authority, Ltd.	31.12.86	40,400
International Centre for Ocean Development	31.03.87	20,800
Laurentian Pilotage Authority	31.12.86	82,400
National Capital Commission	31.03.87	163,300
Northern Canada Power Commission	31.03.87	139,900
Pacific Pilotage Authority	31.12.86	34,600
Royal Canadian Mint	31.12.86	355,900
The St. Lawrence Seaway Authority	31.03.87	140,300
Seaway International Bridge Corporation Ltd	31.12.86	21,200
The Jacques Cartier and Champlain Bridges Incorporated	31.03.87	54,000
Standards Council of Canada	31.03.87	39,900
Teleglobe Canada	31.12.86	347,200



The Office's Comprehensive Auditing Manual is being field tested.

18.110 The costs reported here pursuant to section 149(2) represent the full costs incurred by the Office in carrying out the audit and special examination work and preparing particular reports under section 139 or 143 of the FAA. These costs are reported here only if the work has been completed.

18.111 The total costs of Crown corporations work include costs incurred on work not specifically required under section 139 or 143. This includes, for example, work in relation to issuing prospectuses, advising on information and internal control systems, and helping to resolve accounting issues and to prepare financial statements. The costs incurred for this work are not reported in this chapter.

Annual Audits

18.112 Under section 139 of the FAA, each parent Crown corporation is required to have an annual auditor's report prepared, in respect of itself and its wholly-owned subsidiaries, on the financial statements and on any quantitative information that the Treasury Board requires to be audited. Also, the auditor must prepare such other reports as the Governor in Council may require.

18.113 Exhibit 18.3 shows the costs incurred in performing the completed audits and preparing the annual auditor's reports required by section 139 for those corporations and subsidiaries audited solely or jointly by the Auditor General of Canada. The costs refer to the completed annual audits for fiscal years ending on or before 31 March 1987.

18.114 The costs reported do not include any costs for the audit of quantitative performance information, because no such audits have been requested by the Treasury Board for any of the corporations the Office audited. Similarly, there were no other reports required by the Governor in Council under section 139.

Special Examinations

18.115 Section 143 of the Financial Administration Act requires each parent Crown corporation named in Schedule C of the Act to cause a special examination to be carried out in respect of itself and, if applicable, its wholly-owned subsidiaries, at least once every five years. As the legislation came into effect on 1 September 1984, the first cycle of special examinations is to be completed by 1 September 1989.

18.116 The aim of these examinations is to determine whether, in the period under examination, the financial and management control and information systems and management practices of the corporation were maintained in a manner that provided reasonable assurance that:

- assets were safeguarded and controlled;
- financial, human and physical resources were managed economically and efficiently; and
- operations were carried out effectively.

18.117 At the completion of a special examination, a report on the findings is submitted to the board of directors of the corporation. In the case of corporations named in Part I of Schedule C or their wholly-owned subsidiaries, the legislation provides for the examiner to draw matters to the attention of Parliament if necessary.

18.118 Where, in the examiner's opinion, the special examination report contains information that should be brought to the attention of Parliament, the examiner must, after consulting the board of directors and the appropriate minister, prepare a report on the information for inclusion in the corporation's next annual report. Where an auditor other than the Auditor General of Canada is the examiner, he or she must also consult with the Auditor General and furnish him with a copy of the report on these matters.

18.119 As of 31 July 1987, one special examination of the Northern Canada Power Commission had been completed at a cost to the Office of $484,066. A further 12 special examinations were in progress in Crown corporations that are audited by this Office. Costs of these will be reported in future years, as they are completed.

Advisers to the Auditor General

Membership of the Panel of Senior Advisers

Kenneth G. Belbeck, F.M.C.
Thorne Stevenson & Kellogg

H. Marcel Caron, F.C.A.
Clarkson Gordon

Gordon H. Cowperthwaite, F.C.A.
Canadian Comprehensive Auditing Foundation

Kenneth S. Gunning, F.C.A.
Pannell Kerr MacGillivray

Ralph W. Karthein, CA
IBM Canada Ltd.

Giles R. Meikle, F.C.A.
Deloitte Haskins & Sells

Edward W. Netten, F.C.A.
Price Waterhouse Associates

Donald H. Page F.C.G.A.
Midland Doherty Ltd.

Robert M. Rennie, F.C.A.
Touche Ross & Co.

Donald C. Scott, F.C.A.
Clarkson Gordon

Kenneth R. Stevenson, C.A.
Coopers & Lybrand

T. Robert Turnbull, F.C.A.
Thorne, Ernst & Whinney

W. Ross Walker, F.C.A.
Peat, Marwick, Mitchell & Co.

Membership of the Independent Advisory Committee to the Auditor General on Government Accounting and Auditing Standards

L. Denis Desautels, C.A.
Clarkson Gordon

Kenneth M. Dye, F.C.A. (Chairman)
Auditor General of Canada

James L. Goodfellow, F.C.A.
Touche Ross & Co.

Douglas D. Graham, C.A.
Pannell Kerr MacGillivray

John J. Kelly, C.A.
Canadian Institute of Chartered Accountants

Ronald E. Kiggins, C.A.
Peat Marwick

Gérald Langlois, C.A.
Raymond, Chabot, Martin, Paré & Associé

Claude LeBon, Ph.D., C.A.
Simon Fraser University

P. Howard Lyons, F.C.A.
Deloitte Haskins & Sells

Henry E. McCandless, C.A. (Secretary)
Office of the Auditor General of Canada

Ronald B. Robinson, F.M.C.
Abt Associates of Canada

Lawrence S. Rosen, F.C.A., Ph.D.
York University

Edward R. Rowe, C.A. (Vice-Chairman)
Office of the Auditor General of Canada

Leonard Rutman, Ph.D.
Price Waterhouse

William R. Sloan, F.C.A.
Arthur Andersen & Co.

George F. Windsor, B. Eng., LL.B.
Weir & Foulds

APPENDIX A

AUDITOR GENERAL ACT

25-26 ELIZABETH II

CHAPTER 34

An Act respecting the office of the Auditor General of Canada and matters related or incidental thereto

[*Assented to 14th July, 1977*]

Her Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts as follows:

PART I

SHORT TITLE

Short title

1. This Part may be cited as the *Auditor General Act.*

INTERPRETATION

Definitions

2. In this Act,

"Auditor General"

"Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"Crown corporation"

"Crown corporation" has the meaning assigned by section 95 of the *Financial Administration Act;* s.c. 1984, c. 31, s. 14

"Department"

"Department" has the meaning assigned to that term by section 2 of the *Financial Administration Act;*

"Registrar"

"Registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act.*

AUDITOR GENERAL OF CANADA

Appointment and tenure of office

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem

(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment

(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Vacancy

(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General.

Salary

4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

- S.C. 1976-77, c. 34, s. 4(1);
- S.C. 1980-81-82-83, c. 50, s. 23;
- S.C. 1980-81-82-83, c. 55, s. 1.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him.

DUTIES

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act.

Idem

6. The Auditor General shall examine the several financial statements required by section 55 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

- S.C. 1976-77, c. 34, s. 6;
- S.C. 1980-81-82-83, c. 170, s. 25.

Report to House of Commons

7. (1) The Auditor General shall report annually to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

Submission of report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before the 31st day of December in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receipt thereof by him or, if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Special report

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should not be deferred until the presentation of his annual report.

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 20(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and;

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act;*

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board.

Inquiry and Report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board.

ACCESS TO INFORMATION

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of

the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada.

STAFF OF THE AUDITOR GENERAL

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in *Appropriation Acts*, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under sections 21 and 31 of that Act and inquiries under section 32 of that Act.

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 5(1)(e) and section 7 of that Act.

Collective agreements

17. Any collective agreement affecting persons employed in the office of the Auditor General entered into before the coming into force of this Act remains in force and binds the Auditor General as employer of such persons until the expiry of that agreement.

Classification standards

18. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office.

Delegation

19. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 55 of the *Financial Administration Act* and his reports to the House of Commons under this Act and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General.

ESTIMATES

Estimates

20. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office.

Approbation allotments

21. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of office of the Auditor General

22. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting.

PART II

CONSEQUENTIAL AND RELATED AMENDMENTS

R.S., c. F-10

23. Part VII of the *Financial Administration Act* is repealed.

R.S., c. P-35

24. (1) Part I of Schedule I to the *Public Service Staff Relations Act* is amended by deleting therefrom the words "Office of the Auditor General of Canada".

(2) Part II of Schedule I to the *Public Service Staff Relations Act* is amended by adding thereto the words "Office of the Auditor General of Canada".

R.S., c. E-8

25. Section 16 of the *Established Programs (Interim Arrangements) Act* is repealed and the following substituted therefor:

Powers of Auditor General

"**16.** Nothing in this Act shall be construed to restrict the powers of the Auditor General of Canada under the *Auditor General Act*."

1970-71-72, c. 52

26. Section 27 of the French version of the *Pilotage Act* is repealed and the following substituted therefor:

Vérificateur général

"**27.** Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de chaque Administration et en fait rapport au Ministre."

R.S., c. N-22

27. Subsection 23(5) of the *Northwest Territories Act* is repealed and the following substituted therefor:

Powers of Auditor General

"**(5)** The Auditor General has, in connection with his examination of the accounts of the Territories, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

R.S., c. Y-2

28. Subsection 26(5) of the *Yukon Act* is repealed and the following substituted therefor:

Powers of Auditor General

"**(5)** The Auditor General has, in connection with his examination of the accounts of the Territory, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

1970-71-72, c. 48

29. Section 15 of the French version of the *Unemployment Insurance Act*, 1971 is repealed and the following substituted therefor:

Vérification

"**15.** Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de la Commission et en fait rapport au Ministre."

Amendments to French version

30. Whenever, in the French version, the expression "auditeur général" appears in any provision of an Act listed in the schedule to this Act, there shall in every case, unless the context otherwise requires, be substituted the expression "vérificateur général".

PART III

COMMENCEMENT

Coming into force

31. This Act shall come into force on a day to be fixed by proclamation.

APPENDIX B

FINANCIAL ADMINISTRATION ACT

EXTRACTS FROM PART XII

FINANCIAL ADMINISTRATION ACT

R.S., c. F-10 (amended)

Extracts from Part XII

CROWN CORPORATIONS

Financial Management

Books and systems

138. (1) Each parent Crown corporation shall cause

(a) books of account and records in relation thereto to be kept, and

(b) financial and management control and information systems and management practices to be maintained, in respect of itself and each of its wholly-owned subsidiaries, if any.

Idem

(2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that

(a) the assets of the corporation and each subsidiary are safeguarded and controlled;

(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.

Internal audit

(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the cost of such audits is not justified by the benefits to be derived therefrom.

Financial statements

(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6).

Form of financial statements

(5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.

Regulations

(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1984, c. 31, s. 11.

Auditor's Reports

Annual auditor's report

139. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 138; and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents

(2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of his examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of his examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations

(3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports

(4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph 139(1)*(a)* and on the information referred to in paragraph 139(1)*(b)* if, in his opinion, separate reports would be more appropriate.

Audit of quantitative information

(5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 152(3) be audited.

Other reports

(6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in Council may require.

Examination

(7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit

(8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 138(3). 1984, c. 31, s. 11.

Errors and omissions

140. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 139.

Idem

(2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 139, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.

Correction

(3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

Auditors

Appointment of auditor

141. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.

Auditor General

(2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule C, unless the Auditor General waives the requirement that he be so appointed.

Idem

(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and subsections (8) to (10) do not apply to him.

Exception

(4) Notwithstanding subsection (1), where the report referred to in subsection 139(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and (8) to (11) and section 142 apply in respect of such auditor as though the references therein to a parent Crown corporation were references to the subsidiary.

Criteria for appointment

(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).

Re-appointment

(6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.

Continuation in office

(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed.

Persons not eligible

(8) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation if he is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.

Independence

(9) For the purpose of this section,

(a) independence is a question of fact; and

(b) a person is deemed not to be independent if he or any of his business partners

(i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates,

(ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or

(iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

Resignation

(10) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification.

Qualifications preserved

(11) Nothing in this section shall be construed as empowering the appointment, re-appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re-appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.

Resignation

142. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from him or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination

143. (1) Each parent Crown corporation shall cause a special examination to be carried out, in respect of itself and its wholly-owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 138(1)*(b)* were, in the period under examination, maintained in a manner that provided reasonable assurance that *(a)* the assets of the corporation and each subsidiary were safeguarded and controlled; and

(b) the financial, human and physical resources of the corporation and each subsidiary were managed economically and efficiently and the operations of the corporation and each subsidiary were carried out effectively.

Time for examination

(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan

(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.

Resolution of disagreements

(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation over a plan referred to in subsection (3) may be resolved

(a) in the case of a parent Crown corporation, by the appropriate Minister; and

(b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.

Reliance on internal audit

(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 138(3).

Report

(6) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.

Contents

(7) The report of an examiner under subsection (6) shall include

(a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection (3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and

(b) a statement of the extent to which the examiner relied on internal audits.

Special report to appropriate Minister

(8) Where the examiner of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, report that information to the Minister and furnish a copy of the report to the board.

Idem

(9) Where the examiner of a wholly-owned subsidiary of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of the appropriate Minister, he

shall, after consultation with the boards of directors of the subsidiary and corporation, report that information to the Minister and furnish copies of the report to the boards.

Special report to Parliament

(10) Where the examiner of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, prepare a report thereon for inclusion in the next annual report of the corporation and furnish copies of the report to the board, the appropriate Minister and the Auditor General of Canada.

Idem

(11) Where the examiner of a wholly-owned subsidiary of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the boards of directors of the subsidiary and corporation, prepare a report thereon for inclusion in the next annual report of the corporation and furnish copies of the report to the boards, the appropriate Minister and the Auditor General of Canada. 1984, c. 31, s. 11.

Examiner

144. (1) Subject to subsections (2) and (3), the auditor of a parent Crown corporation shall carry out a special examination.

Idem

(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, he may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception

(3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions

(4) Subject to subsection (5), subsections 141(8) to (10) and section 142 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible

(5) The Auditor General of Canada is eligible to be appointed an examiner and subsections 141(8) to (10) do not apply to him in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General

145. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 139(2)*(b)* or subsection 143(10) or (11). 1984, c. 31, s. 11.

Right to Information

Right to information

146. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem

(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the information and explanations so obtained to the auditor or examiner.

Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

147. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

(a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(b) the objectives of the corporation; and

(c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

148. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation has qualified privilege. 1984, c. 31, s. 11.

Costs

Cost of audit and examinations **149.** (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 139 or 143 shall be reported to the President of the Treasury Board.

Idem (2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 139 or 143 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee **150.** (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem (2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties (3) The audit committee of a parent Crown corporation shall

(a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;

(b) oversee any internal audit of the corporation that is conducted pursuant to subsection 138(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 139(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in section 143; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor or examiner's attendance (4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard thereat; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting (5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary (6) Where the report referred to in subsection 139(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references therein to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)*(a)* to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister **151.** (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments (2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-owned subsidiaries (3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report **152.** (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee (2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the business and activities of the corporation submitting the report.

Form and contents (3) The annual report of a parent Crown corporation shall include

(a) the financial statements of the corporation referred to in section 138;

(b) the annual auditor's report referred to in subsection 139(1);

(c) a statement on the extent to which the corporation has met its objectives for the financial year;

(d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included therein; and

(e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included therein;

and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.

Idem

(4) In addition to any other requirements under this or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1984, c. 31, s. 11.

Annual consolidated report

153. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.

Reference to committee

(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.

Contents

(3) The annual consolidated report referred to in subsection (1) shall include

(a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;

(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and

(c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.

Quarterly report

153.1 (1) The President of the Treasury Board shall cause to be laid before each House of Parliament a copy of a report indicating, in respect of each quarter of each calendar year, the summaries and annual reports that under this Part were to be laid before that House in the quarter, the time at, before or within which they were to be laid and the time they were laid.

Attest

(2) The accuracy of the information contained in each quarterly report shall be attested by the Auditor General of Canada in his annual report to Parliament.

Time for tabling quarterly report

(3) A quarterly report shall be laid before each House of Parliament pursuant to subsection (1) on any of the first thirty days on which that House is sitting after the end of the quarter to which the report relates. 1984, c. 31, s. 11.

APPENDIX C

REPORTS TO THE STANDING COMMITTEE ON PUBLIC ACCOUNTS TO THE HOUSE OF COMMONS

REPORT TO THE HOUSE

Tuesday, November 4, 1986

The Standing Committee on Public Accounts has the honour to present its

FIRST REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1985 and, in particular, paragraphs 3.57 to 3.64, audit observations related to an income tax remission order under the auspices of the Department of Finance (the Department).

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. In February 1985 a remission order pursuant to Section 17 of the Financial Administration Act was granted to Hudson's Bay Oil and Gas Limited, a subsidiary of Dome Petroleum Limited. Over a ten-year period, Hudson's Bay Oil and Gas was authorized to deduct for income tax purposes the financing costs that Dome incurred in acquiring it. The value of the remission order is considerable. To date, the Auditor General has estimated that $400 million has been expended.

4. Your Committee has a number of concerns with respect to this remission order:

(a) Parliament's consent was not sought and Parliament was not involved in a substantial expenditure of public funds;

(b) a corporate loss transfer procedure was used, a procedure not otherwise allowed in law and currently before Parliament as a proposal in a budget discussion paper;

(c) there was an unconventional and unprecedented use of a remission order which was approved on the basis of the broad and general criterion of "being in the public interest";

(d) there were less costly alternatives to the use of a remission order;

(e) analysis upon which the remission order was based was initially withheld from the Auditor General; and

(f) the amount of the remission order was not reported in the Public Accounts as required by government directives pursuant to the Financial Administration Act.

5. Although remission orders are generally a means of granting relief from some aspects of the tax system, your Committee noted that in the Dome case a remission order was used as a means of implementing public policy. The Department stated that the purpose of

the remission order was to support private sector refinancing of Dome and to replace a previous government commitment to invest $500 million in the company. The large amounts of public money involved and the unconventional use of a remission order suggest to your Committee that the matter should have been brought before Parliament.

6. Your Committee noted that the criterion for government approval of a remission order pursuant to Section 17(1) of the Financial Administration Act is that it is considered to be "in the public interest". Your Committee considers that the application of such a broad and general criterion should be explained where large sums of public money are involved.

Recommendations

7. Your Committee recommends that the Government give consideration to amending the Financial Administration Act to require the following:

> ***(a)*** **the tabling in Parliament of all income tax remission orders;**
>
> ***(b)*** **the preparation of an explanatory note, to accompany each remission order so tabled, outlining why the remission order is in the public interest;**
>
> ***(c)*** **the reference of all remission orders so tabled to the appropriate Standing Committees; and**
>
> ***(d)*** **the prior approval by Parliament of all income tax remission orders exceeding $20 million in value.**

8. The Department informed your Committee that the use of a corporate loss transfer in the Dome case was not offensive to existing tax policy concepts. Your Committee disagrees. The Income Tax Act permits companies to incur interest obligations for buying the shares of other companies, and then through amalgamation or winding-up to make the two companies one and have the income of the acquired company offset against the interest expense of the acquiring company. However, your Committee noted that Dome and Hudson's Bay Oil and Gas did not amalgamate. The remission order was therefore used to circumvent the Income Tax Act. Moreover, the remission order made use of a procedure outlined in a budget paper currently before Parliament. As the Auditor General noted, the budget paper referred to the corporate loss transfer system as "a new concept". This concept needed to be "fully discussed before implementation". The Dome tax remission therefore pre-empted Parliamentary consideration of an innovative and significant tax measure.

Recommendation

9. Your Committee recommends that the Minister of Finance in future ensure that income tax remission orders do not deal with any matter currently before Parliament.

10. Your Committee noted that in this case a remission order was used to replace an offer to purchase debentures. Unlike some form of investment or other available means of

financial support, a remission order constitutes an unqualified benefit. There is no provision for reimbursement of the Crown. Your Committee is concerned that less costly methods of supporting Dome were not pursued.

11. Your Committee also noted that the remission order did not limit the benefit to the present owner of Hudson's Bay Oil and Gas. In view of the fact that the stated intention was to support Dome this omission may result in an unintended benefit to another taxpayer should Dome decide to sell.

Recommendation

12. Your Committee recommends that, where applicable, future remission orders include conditions specifying the ownership of the companies for whom the benefit is intended.

13. The Auditor General stated that the Department did not inform him, when requested to do so, that an economic analysis of this remission order had been prepared for Cabinet. The Auditor General was thereby denied access to pertinent information. Your Committee is greatly concerned by this interference with the work of the Auditor General. Your Committee considers that the Auditor General, as a servant of Parliament, is entitled to reasonable access to non-political information, including economic studies.

14. Section 17(8) of the Financial Administration Act requires that remission orders be reported in the Public Accounts. Directives issued pursuant to this Section call for a listing of the amounts of each remission. In spite of these statutory requirements, no amount was reported for the Hudson's Bay Oil and Gas remission order in the 1984-85 Public Accounts.

15. The Department stated that it was not possible to calculate the cost of the remission order because of the difficulty of estimating both Dome's future tax liability and the "net cost" of the remission (its costs less the benefit of Dome's continued solvency). For these reasons the Department criticized the Auditor General's estimate of a $1 billion after-tax cost.

16. Your Committee noted that this remission order took effect retroactively and that amounts have already been expended. Such amounts must be reported in the Public Accounts. If an exact figure is not available an estimate should be prepared together with a notation explaining its method of calculation. Thee is no need to attempt to calculate "net cost" in order to comply with the statutory requirement to disclose the amount of the remission order. With respect to the total value of the remission order, your Committee considers that an estimate such as the one prepared by the Auditor General is a helpful indicator of the extent of the commitment of public funds.

Recommendation

17. Your Committee recommends that the Treasury Board develop guidelines for the reporting in the Public Accounts of the estimated amounts of remission orders where an exact figure is not available.

18. Your Committee requests that the Government provide a comprehensive response to this report in accordance with S.O. 99(2).

19. A copy of the relevant Minutes of Proceedings and Evidence (*Issue No. 34 from the First Session and Issue No. 2 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON,
Chairman

REPORT TO THE HOUSE

Thursday, December 18, 1986

The Standing Committee on Public Accounts has the honour to present its

SECOND REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Reports of the Auditor General to the House of Commons for the fiscal years ended March 31, 1984 and March 31, 1986 and, in particular, the comprehensive audit of the Department of Public Works (Follow-up to the Committee's Second Report of the First Session of this Parliament) and audit notes contained in paragraphs 3.21 to 3.41 (1986 Auditor General's Report).

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

Response to Previous Committee Report

3. In April 1985 your Committee tabled its Second Report on the comprehensive audit of the Department. At that time, your Committee was concerned about the failure of the Treasury board to enforce its rules and the failure of the Department to obey them. Cases of weak management in the Department's accommodation program, its failure to adequately inform ministers, and delays in the implementation of revenue dependency were also of concern to your Committee.

4. The Department informed your Committee that action has been taken on all but two of the recommendations in the Second Report. Still outstanding are a plan for accommodation of government departments in the National Capital Region and the completion of an effective cost accounting system. Your Committee will monitor the Department's progress in these areas.

5. In its Second Report, your Committee stressed the importance of reliable information for sound decision-making. Your Committee is therefore concerned by the Department's lagging progress in systems development. When information was requested on cost overruns, data for only one region of the country was available. Other information had to be compiled manually. Another example was the Department's inability to ensure that the responsible project managers were getting information when they needed it. In some cases, the Department's ceiling on delegated authority for contract amendments was exceeded and managers did not know about escalating costs in time to seek the required Treasury Board approval.

6. In response to your Committee's concerns, the Department tabled a detailed status report on the development of its financial management system, with target dates

extending into 1988. Your Committee expects the Department to keep to this schedule and ensure that systems respond effectively to information needs.

7. Your Committee is concerned by the continuing delays in implementing revenue dependency. With respect to architectural, engineering and real estate services, the Department has set a target date of April 1988. In view of Treasury Board's 1985 direction to the Department to initiate market rates for these services "as soon as possible", your Committee considers the Department's progress unacceptably slow. Your Committee is also concerned by the fact that an initial presentation to Treasury Board on revenue dependency in the accommodation program has yet to be made.

8. Your Committee noted that 4,500 professional and support staff provided architectural and engineering services across the public service, with approximately 1,400 of these located in the Department. In its Second Report, your Committee asked the Department to demonstrate the continuing need for these significant resources. In view of the current program to rationalize such services and consolidate them in the Department, your Committee wishes to re-emphasize its earlier concern and stress the Department's responsibility to avoid duplication in the provision of costly professional services.

9. The Department informed your Committee of measures to improve cost-consciousness in its own ranks and in client departments, in conjunction with the adoption of the new regime for real property management. Your Committee encourages the Department to pursue such activities, notably the issue of instructions to staff on compliance with Treasury Board rules and improvements in staff training.

Recommendations

10. Your Committee recommends that the Department submit a written progress report by March 31, 1987 and again by September 30, 1987 with respect to the following:

(a) **accommodation planning in the National Capital Region;**

(b) **cost accounting systems and the financial management system;**

(c) **rationalization of architectural and engineering services; and**

(d) **improvements in cost-consciousness.**

11. Your Committee recommends that the Department simultaneously provide the progress report mentioned in recommendation 10 above to the Auditor General and that the Auditor General assess and provide his comments on these reports to your Committee within a reasonable period.

Competitive Tendering

12. In view of the fairness and economy of the competitive process, your Committee is not satisfied with the Department's extensive use of exemptions to the Treasury Board regulations on mandatory tendering of contracts. Over 80 per cent of leasing transactions were not publicly tendered in fiscal year 1985-86.

13. Treasury Board officials stated that they had delegated the enforcement of their contracting regulations, including the exemptions to competitive tendering, to the internal audit function in departments.

14. Your Committee considers that Treasury Board should take a more active role in the approval of exemptions to its contracting regulations. The improvement in the Department's use of the competitive process since the Committee's last report has not been satisfactory. Your Committee sees a role for the central agency to control and limit non-competitive tendering of contracts.

Recommendations

15. Your Committee recommends that the Department:

(a) **ensure the maximum use of competitive tendering for contracts; and**

(b) **advise your Committee in writing by September 30 of each year of the extent of competitive tendering of contracts for the fiscal year ended March 31.**

16. Your Committee recommends that the Treasury Board Secretariat review exemptions to mandatory tendering of contracts (Section 8 of the Government Contracts Regulations) and report to your Committee by March 31, 1987.

Relationship with Client Departments

17. Your Committee considered several cases of cost overruns and contract-splitting involving the Department and various client departments. An important common theme of these cases was the need to improve communications and assign responsibilities to staff in the Department and in client departments in order to ensure that requirements were clearly defined before contract or project approval.

18. In one case of cost overrun and retroactive approval in a construction contract, the Department noted that, because of a tight schedule, the client department requested changes both in the requirements for the structure as well as the completion date. The Department stated that: "it did not really question (the client's) reasons". Your Committee finds the Department's attitude completely unacceptable.

19. Another case involved the splitting of a contract into several parts to bypass the Department's ceiling on delegated authority. One of the reasons for the failure to establish the total value of the contract at the time of the initial approval was the inability of the client department to decide, over a one-year period, that it needed closed rather than open office space.

20. With respect to the delay in occupancy of the Louise St. Laurent building in Hull, Québec, which cost the Crown in excess of $7 million, the Department accepted responsibility for the problems which arose in determining client requirements. Although the need for space was defined as early as September 1983, the specifications for its use were not settled until after rental payments had started in September 1985. With fit-ups incomplete, the client could not occupy the building and public money was wasted on non-productive rents.

21. Your Committee cannot accept the existing loose relationship between the Department and client departments. Client needs must be firmly established before expenditures are incurred. In addition, more attention must be given to coordinating all phases of construction to avoid unnecessary costly delays. In the opinion of your Committee, there is a role for Treasury Board, as an independent authority, to ensure that requirements are finalized in advance of contract or project approval.

Recommendations

22. Your Committee recommends that Treasury Board Secretariat:

(a) **develop and co-ordinate guidelines and procedures for use by the Department of Public Works and its client departments to ensure definition of requirements prior to contract or project approval; and**

(b) **report its progress in so doing in writing by March 31, 1987.**

Relationship with Treasury Board

23. Your Committee wishes to express its disapproval, in the strongest possible terms, of situations such as the cases of contract-splitting where the Department knew in advance that Treasury Board approval would be required, but did not seek it.

24. Your Committee considers that reasonable Treasury Board rules should be followed. Where directives or guidelines are too rigid or out-of-date, that problem should be addressed.

25. Treasury Board officials stated that agreement had been reached on upward revisions in authorities delegated to the Department. In addition, as part of Increased Ministerial Authority and Accountability, Treasury Board will be negotiating a memorandum of understanding with the Department which may include further authority revisions and greater flexibility in the administration of regulations. Your Committee will monitor the outcome of these negotiations.

26. Your Committee noted that the last revision of delegated authority occurred in 1983. In view of rapid escalation since then in construction costs, your Committee is concerned that such changes be responsive to industry conditions.

27. With reference to the conditions set by Treasury Board for the lease of the Louis St. Laurent building, the Auditor General found that the directions given to the Department, although specific, were not followed. Treasury Board officials said that the directions were "not that specific". The concern of your Committee is that instructions intended to ensure economical use of public funds be followed. To be followed they must be clear. Both Treasury Board and the Department should ensure that future directions are clearly understood and acted upon.

28. With respect to cost overruns, a Treasury Board official noted that departments which have project overruns are required to absorb the overrun out of that year's capital project budget. In many projects, an overrun may occur in one or more of the contracts that form part of the project. The Department referred to a penalty of a loss of twice the amount of the overrun in the next year's capital budget. However, these penalties do not apply to an overrun resulting from a change in requirements or specifications. In view of the fact that the taxpayers' money is at risk, your Committee favours penalties for al types of overruns.

Recommendations

29. Your Committee recommends that Treasury Board:

(a) **report in writing on the outcome of the Increased Ministerial Authority and Accountability negotiations with the Department of Public Works when these negotiations are completed or, in any event, by September 30, 1987;**

(b) **impose a penalty of twice the amount of a cost overrun, including contract overruns and overruns resulting from avoidable changes in requirements, on the subsequent year's budget of the department concerned; and**

(c) **respond in writing to recommendation 29(b) above by March 31, 1987.**

30. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 3, 4, 7 and 8 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON,
Chairman

REPORT TO THE HOUSE

Monday, February 9, 1987

The Standing Committee on Public Accounts has the honour to present its

THIRD REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1986 and, in particular, Chapter 12, the comprehensive audit of the Department of Insurance (the Department).

2. The co-operation of the witnesses who appear before your Committee is acknowledged and appreciated.

3. Your Committee is pleased to note the positive response which the Department has taken with respect to the recommendations of the Auditor General and the action taken to date as reported by the Department. However, your Committee would like to identify specific areas where further action is necessary. They include the supervision of pension plans and financial institutions, the upgrading of methodology and work tools within the Department.

Supervision of Pension Plans

4. The Auditor General has noted in his annual report that the supervision of pension plans by the Department does not involve regular on-site examinations similar to those conducted for financial institutions and relies too heavily on representations from management. He has called for a thorough review by the Department of its supervisory practices.

5. Your Committee notes the views of the Auditor General and the Department with respect to the adequacy of supervision of pension plans and their level of financial solvency. The risk of financial loss is viewed differently by the Auditor General and the Department. Although your Committee sees pension plans in a different category from the other deposit-taking financial institutions, it concludes nevertheless, that the Department is charged with the responsibility of ensuring that the assets and liabilities of all federally regulated pension pans are actuarially sound and are audited on a regular basis and that procedures are in place to assess financial solvency. Your Committee is therefore concerned that the Department's reliance on independent actuarial and audit reports is on a triennial basis and on a small number of on-site examinations. Your Committee is pleased, therefore, to note that the Department will be undertaking an independent evaluation of its current supervisory procedures and practices of pension plans before May 31, 1987.

6. Your Committee observes that the new provisions under the Pension Benefits Standards Act 1985, which came into effect on January 1, 1987, will require, among other

things, a regular annual audited financial statement of pension funds and tighter restrictions by the federal regulator on the withdrawal of pension fund surpluses.

Recommendation

7. Your Committee recommends that the Department advise it by June 15, 1987 of the action it intends to take on the results of the independent evaluation study.

Supervision of Financial Institutions

8. The Auditor General has observed that the Department has strengthened its supervisory function of financial institutions as a result of recent failures of trust and loan companies, and property and casualty insurance companies. However, he has concluded that unless the Department improves its process for monitoring and assessing the financial solvency of the companies it regulates, it may be placing itself in a position where it will not be able to detect financial problems early enough in order to take steps to avoid them.

9. Your Committee notes that the Department agrees with this assessment and has taken some action to document its processes and criteria for determining areas of risk and for monitoring and assessing industry trends and the financial solvency of companies; and plans to review and evaluate these processes and criteria annually. Your Committee is concerned that the Department does not have adequate resources to improve its supervisory processes.

Recommendations

10. Your Committee recommends that:

***(a)* the Government ensure that sufficient resources are available for the supervision of financial institutions; and**

***(b)* the Department advise your Committee by June 15, 1987 on the action taken by the Department in improving its processes for monitoring and assessing financial solvency of the financial institutions it regulates.**

Methodology and Work Tools

11. The Auditor General has expressed concern about the lack of documentation of field-examination standards and procedures and the efficiency of certain out-dated work tools. The Department has been slow to upgrade its methods and technology because it has been limited in its financial resources. Your Committee notes that in response to the Auditor General's criticism and recommendations, the Department is now actively updating its standards and procedures both in the field and at head office and is in the process of upgrading its computer technology.

Recommendation

12. Committee recommends that the Auditor General monitor the Department's progress in updating its methodology and upgrading its work tools and report back to the House as part of his regular follow-up.

13. A copy of the relevant Minutes of Proceedings and Evidence (*Issue Nos. 5, 6 and 10 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON,
Chairman

REPORT TO THE HOUSE

Monday, March 9, 1987

The Standing Committee on Public Accounts has the honour to present its

FOURTH REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1986 and, in particular, Chapter 11, the comprehensive audit of the Department of Indian Affairs and Northern Development (the Department).

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. In examining the major issues of this comprehensive audit, your Committee recognized the importance of sound management of Indian lands and moneys. Accordingly, the present report will focus on this subject.

Management of Indian Lands and Moneys

4. In a 1984 decision involving the surrender of Indian lands (the case of Guerin et al.v. The Queen), the Supreme Court of Canada held that the Department had a fiduciary duty to Indian people. In that case, the court awarded damages of $11.7 million to an Indian band. Your Committee noted that approximately 100 other lawsuits are pending against the Crown. The 25 per cent of these claims with a dollar value represent a potential liability of $1.77 billion. The balance, 75 per cent, have no stated dollar value.

5. In the view of your Committee, the existence of fiduciary responsibilities, at least with respect to surrenders of Indian land, requires the Department to examine and revise its procedures and policies. Your Committee considers that Indian people should receive the same standard of care that all Canadians would expect from a professional trustee administering lands, estates and moneys. Moreover, the Department must protect the Crown against potentially significant future legal liabilities.

6. For Indian band trust accounts, the Department informed your Committee that it sought to attain the standards of a professional trustee. However, for its other responsibilities, the Department sought accuracy and higher standards but not the standard of care of a professional trustee. In the Department's view, the precedent of the 1984 Supreme Court decision has limited application beyond specific situations of land surrender. Your Committee questions this view. In order to serve Indian people better and protect the interest of the Crown, your Committee suggests that the Department should conform to the standards of a responsible private sector trustee.

7. Your Committee considers that resolution of the issue of the Department's fiduciary responsibilities towards Indian people will assist the process of the transfer of responsibilities to Indian bands. At the same time, the interests of those bands which do not seek full control of their affairs at the present time will be better protected.

Recommendations

8. Your Committee recommends that the Department:

***(a)* meet the standard of care of a professional trustee in its administration of Indian lands, estates and moneys; and**

***(b)* respond to this recommendation in writing by April 30, 1987.**

9. Your Committee noted the following areas where the Department's management of Indian lands, estates and moneys did not meet professional standards:

(a) lack of a complete and accurate national inventory of reserve land and natural resources by individual Indian bands;

(b) inadequate access to the assistance of specialists, including lawyers, surveyors and assessors, in processing land transactions;

(c) deficiencies in training or experience of personnel handling leases, land surrenders and estates;

(d) an inadequate system and procedures for handling Indian estates;

(e) excessive backlogs in the processing of estates;

(f) inadequate review of proposed expenditures from Indian band capital accounts; and

(g) release of funds from trust accounts for minors without adequate safeguards.

10. The Department indicated three types of responses to these deficiencies: amendments to the *Indian Act*; a comprehensive study under the auspices of the Comptroller General; and interim action pending completing of this study or introduction of such amendments.

11. With respect to the Indian Act, your Committee recommended in 1985 (First Report, 1st Session of this Parliament) that the Department immediately seek a judicial opinion regarding Subsection 64(1)*(k)* in order to ensure that the Crown was not exposed to future legal liability concerning payment of moneys from Indian capital accounts. Although the Department has not acted on this recommendation, the Auditor General informed the Committee that safeguards over the release of capital moneys have improved. The Department also stated that proposed amendments to this Section of the *Indian Act* and to the Section dealing with payment from trust accounts for minors would be put forward to the

Minister in the near future. Your Committee will monitor the Department's progress in this regard.

12. Your Committee wishes to be kept fully informed of the progress and results of the Comptroller General's comprehensive review of the Department's management of Indian lands, revenues and trusts. The Department indicated an approximate timeframe of one year for the completion of this study.

13. Notwithstanding various studies and the development of proposals for amendments to the *Indian Act*, your Committee noted a number of specific undertakings by the Department for remedial action over the next three years:

(a) a status report by April 30, 1987 on measures to upgrade staff through training and recruitment;

(b) a status report on management of Indian capital accounts by April 30, 1987;

(c) completion of a property map system in June 1987;

(d) a review of resources needed for the improved handling of Indian estates by October 1987, with elimination of the backlog in estates by the Spring of 1988;

(e) completion of an inventory of forest resources of Indian bands by December 31, 1987;

(f) completion of the inventory of non-renewable resources, with varying timeframes by region, over the period from December 31, 1987 to 1990; and

(g) introduction of an automated land registry system by March 1990.

Recommendations

14. Your Committee recommends that the Department:

***(a)* provide your Committee with a written status report with respect to proposed amendments to the *Indian Act* by June 1, 1987 and again by March 31, 1988;**

***(b)* report to your Committee in writing on the workplan and timetable for the Comptroller General's study of Indian lands, revenues and trusts by April 30, 1987;**

***(c)* report to your Committee in writing with respect to the commitments listed in paragraph 13 above by April 30, 1987 and at six month intervals thereafter until all the commitments have been met; and**

***(d)* provide copies of the aforementioned reports simultaneously to the Auditor General, who is to assess these reports on behalf of your Committee and report his findings within a reasonable period.**

15. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 8, 9 and 12 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON,
Chairman

REPORT TO THE HOUSE

Monday, March 16, 1987

The Standing Committee on Public Accounts has the honour to present its

FIFTH REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1986 and, in particular Chapter 11, the comprehensive audit of the Department of Indian Affairs and Northern Development (the Department).

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. In an earlier report (Fourth Report of this Session), your Committee considered the management of Indian lands and moneys. In the present report, the other major issues arising from the comprehensive audit of the Department are examined.

Mandate of the Department

4. With respect to the mandate question, whether the Department sought social and economic gains for Indian people or provided financial support while Indian groups pursued their own objectives, your Committee received a document from the Department outlining its priorities. The Department stated that it pursued both orientations, but favoured Indians taking charge of their own affairs.

5. Your Committee shares the Auditor General's concern that the measures of accountability may be quite different for the two approaches to the Department's mandate. The Department needs to clarify this issue, which was raised in your Committee's previous report of June 23, 1981 (Sixth Report, 1st Session, 32nd Parliament).

Recommendation

6. Your Committee recommends that the Department clarify the accountability implications of the two mandate orientations set forward by the Auditor General and respond to this recommendation in writing by April 30, 1987.

Elementary and Secondary Education

7. The Department is responsible for providing all eligible Indians with access to a quality and range of education relevant to their needs. Whether education is provided by the provinces, by the Indian bands or directly by the Department, the Department must provide

clear operational direction to allow for local needs and to ensure that minimum standards are met. Since the Assembly of First Nations and the Department have embarked on a comprehensive study of Indian education, your Committee will be interested in the result of this study and the commitment of the Department to adopt a comprehensive policy.

Contributions to Indians Bands

8. The Auditor General informed your Committee of his continuing concern over appropriate controls for contributions to Indian bands. With the transfer of program delivery responsibilities to Indian bands, the Department has not always been able to ensure that these funds were used for the purposes for which they were given, as required by Treasury Board. This issue has been the subject of recommendations in previous reports of your Committee, most recently in February 1985 (First Report, 1st Session of this Parliament). The Department has responded with alternative funding arrangements, which would allow Indian bands to oversee the details of multi-year expenditures. In contrast to contributions, the new arrangements would allow Indian bands to design programs, on the basis of accountability to the community electorate, and re-allocate funds from one purpose to another. Accountability to Parliament could be maintained through annual audit and other requirements governing eligibility of Indian bands.

Recommendations

9. Your Committee recommends that the Department:

***(a)* ensure that contributions to Indian bands are subject to appropriate controls and provide a written report to your Committee in this regard by March 31, 1988;**

***(b)* report to your Committee in writing on its progress in implementing alternative funding arrangements, with respect to the soundness of accountability measures and the extent of Indian band involvement, by March 31, 1988; and**

***(c)* provide the aforementioned reports simultaneously to the Auditor General, who is to assess these reports on behalf of your Committee and report his findings within a reasonable period.**

Native Claims

10. Your Committee heard that the Department had failed to specify clearly the timing, costs and responsibilities for implementing the federal government's obligations for the James Bay and Northern Québec Agreement. Over a ten year period, the Department has been unable to finalize this agreement. With three claims settlements reached and other major settlements pending, the Department stated that procedures have been improved, including the recent announcement of an implementation plan for each agreement. In view of the extent of the problems with the Québec agreement, your Committee is concerned about the adequacy of the Department's new procedures.

11. Your Committee was concerned that the Department had not tabled annual reports on the James Bay and Northern Québec Agreement, as required by statute. From 1982 to 1985, no such report was tabled. On December 19, 1986 one annual report, covering the elapsed period, was tabled in the House. Your Committee considers annual reports to Parliament on claims settlements an important part of the accountability process.

12. With respect to the liabilities represented by native land claims settlements, your Committee noted that the government was unable to determine the amounts ultimately payable. No figure therefore appears in the Statement of Contingent Liabilities in the 1985-86 Public Accounts, other than an estimate of $2.9 billion in respect of pending and threatened litigation arising from the administration of native statutory and treaty obligations. In the opinion of your Committee, these liabilities should be estimated and included in the Statement of Assets and Liabilities in the government's financial statements.

Recommendations

13. Your Committee recommends that the Department:

(a) **report in writing its progress in implementing improved native claims settlement procedures by March 31, 1988; and**

(b) **simultaneously provide the aforementioned report to the Auditor General, who is to assess this report on behalf of your Committee and report his findings within a reasonable period.**

14. Your Committee recommends that the Minister of Indian Affairs and Northern Development table annual reports on all native claims settlements.

15. Your Committee recommends that the Government consider the advisability of including in its Statement of Assets and Liabilities provision for liabilities represented by native land claims settlements.

16. Your Committee requests that the Government provide a comprehensive response to recommendations 14 and 15 above in accordance with S.O. 99(2).

17. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 8, 9 and 13 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON,
Chairman

REPORT TO THE HOUSE

Wednesday, May 20, 1987

The Standing Committee on Public Accounts has the honour to present its

SIXTH REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1986, and, in particular, Chapter 9, the comprehensive audit of the Department of External Affairs - Trade Function (The Department).

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

Level of Service and Cost Recovery

3. Under the auspices of the Department, the trade commissioner service assists Canadian exporters to penetrate foreign markets. In posts abroad, a wide range of services are provided. This includes support to business, participation in trade fairs, analysis of market opportunities and advice on international trade policy. In view of the importance of international trade to the Canadian economy, it is essential that the Department's trade officers respond effectively and comprehensively to requests for assistance from the business community.

4. Your Committee noted with concern the Department's ad hoc approach to defining the level of service offered to Canadian business at posts abroad. The Auditor General informed your Committee that the Department does not have a list of services for each post and does not know the cost of the services it provides. In the view of your Committee, a clear definition of the expected level of services to be provided under various circumstances would assist the business community and improve the Department's procedures to allocate staff and control costs.

5. The Department undertook to review the level of service at posts abroad and informed your Committee about new information systems and the development of strategic approaches to the marketing of export commodities.

6. With respect to cost recovery, the Department stated that it had not taken a decision on partial or full recovery of costs for various documents, market analyses and data from information systems that are made available to business. However, enhanced cost recovery has been put in place for participation by companies in trade fairs. Your Committee noted that other countries, notably the United States, have established an extensive system to recover costs for documentation.

Recommendations

7. Your Committee recommends that the Department:

(a) **establish levels of service and improve its procedures to allocate staff and control costs at each post abroad;**

(b) **decide upon levels of cost recovery; and**

(c) **respond in writing to the foregoing recommendations by September 30, 1987.**

Personnel

8. Your Committee is concerned by the fact that there have been four deputy ministers for international trade in the last two years. This practice of rapid turnover in senior personnel, which is by no means unique to this department, seriously weakens the accountability process and interferes with sound management.

9. Your Committee recommended in an earlier report that the Department improve its personnel planning and assignment system (21st Report, 1st Session, 32nd Parliament, 24 October 1983). At that time the Department undertook to improve its personnel information system, including data on trade staff, and devote additional resources to this system. Yet, in the 1986 audit, the Auditor General found that personnel plans contained insufficient information and, as a consequence, candidates with more relevant skills were not always considered for assignments to posts abroad. Although the Department responded that information from other sources was used in the assignment process, your Committee is not satisfied with the slowness in upgrading the personnel information system. Moreover, the Department's actions have not been in keeping with its earlier statements of intention to your Committee.

10. Your Committee shares the Auditor General's concern that the allocation of trade officers to posts abroad should correspond to the pattern of trade flows. Although your Committee noted that the Department has recently re-allocated staff from Europe to the Asia-Pacific region, the data provided to your Committee points to a continued imbalance in terms of the numbers of trade officers in Europe relative to the pattern of trade flows.

11. In view of the cost savings that may be gained through the use of locally-engaged staff, your Committee suggests that the Department review the mix of Canadian versus local staff at posts abroad.

12. Your Committee considers that the trade function is more efficiently and effectively carried out if trade officers accept longer postings abroad. A two-year posting may be too brief to establish appropriate commercial contacts. The trend noted by the Department to significant numbers of trade officers extending their postings needs to be encouraged.

Recommendations

13. Your Committee recommends that the Prime Minister give consideration to the appointment of deputy ministers for a period long enough to be held accountable for their actions. Your Committee requests a Government response to this recommendation pursuant to S.O. 99(2).

14. Your Committee recommends that the Department:

(a) **develop improved personnel information systems and personnel policies as recommended by the Auditor General**

(b) **ensure that the allocation of trade officers to posts and regions corresponds with the pattern of Canada's trade flows;**

(c) **review the mix of Canadian versus locally-engaged trade personnel;**

(d) **encourage extension of postings for trade officers;**

(e) **report to your Committee in writing with respect to the foregoing recommendations by September 30, 1987; and**

(f) **simultaneously provide a copy of the aforementioned report to the Auditor General, who is to assess it on behalf of your Committee and report his findings within a reasonably period.**

Co-ordination with Other Government Departments

15. In view of the way the trade function is organized, with the Department of External Affairs relying on other government departments for sectoral and technical expertise, your Committee considers that officials in the various departments need to be team-players, with effective co-ordination based on the common objective of promoting Canada's exports. In this perspective the improvements suggested by the Auditor General, such as operational guidelines defining interdepartmental roles and better communication procedures, take on added importance.

16. One key relationship is with the Department of Regional Industrial Expansion (DRIE). It is essential to co-ordinate DRIE's knowledge of Canadian products with External Affairs' knowledge of international markets. Your Committee heard about "rough edges" in the relationship between the two departments arising from a major reorganization in 1982-83. As the Auditor General pointed out, improved planning procedures and better consultation with DRIE and its regional offices are a "first step" that External Affairs is now taking. Your Committee will be interested in the Department of External Affairs' progress in this regard.

17. In the Department's relationship with the Department of Agriculture and other functional departments, your Committee noted the need to develop export strategies for specific products. For example, in the case of pork marketing in Japan, your Committee noted

that the Department of External Affairs did not have an explicit management plan or framework for action to protect Canada's market share.

18. The Department claimed improvements in its relationship with the Department of Agriculture, including agreed guidelines on the division of responsibilities. In view of the Auditor General's finding that interdepartmental meetings sometimes resulted in poor reporting, your Committee emphasizes the need for clearly documented procedures and will monitor progress in this area.

Recommendations

19. Your Committee recommends that the Department:

(a) provide a written report to your Committee by September 30, 1987 on the measures taken to improve the operating relationships with other government departments and implement the Auditor General's recommendations in this area; and

(b) provide a copy of the aforementioned report simultaneously to the Auditor General, who is to assess it on behalf of your Committee and report his findings within a reasonable period.

The Program for Export Market Development

20. Through repayable contributions to Canadian exporters, the Program for Export Market Development (PEMD) shares with business the risks of penetrating foreign markets. The program reimburses 50 per cent of expenses, such as bidding on projects and participation in trade fairs. With respect to the weaknesses noted by the Auditor General in the approval, monitoring and recovery of payments under the program, the Department outlined a number of remedial measures to take effect on April 1, 1987. Given the broad scope and newness of the measures outlined by the Department, including revised eligibility criteria and reporting requirements, your Committee will reserve its comments at this time. Your Committee will be interested in the results of the Auditor General's follow-up in his 1988 Annual Report.

21. A condition of receiving a PEMD contribution is that the company must repay the contribution if it achieves increased sales in that market. Repayments are usually 2 per cent of new sales. Recipients of PEMD assistance are given three years from the end of the project to repay the Crown. Companies are required to report these new sales to the Department. Although the Department is attempting to contact the 5,500 companies that were delinquent in their reporting, only 45 per cent have responded to date. Your Committee urges the Department to pursue further recoveries.

22. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 14, 15 and 20 which includes this report)* is tabled.

Respectfully submitted,

AIDEEN NICHOLSON,

Chairman

REPORT TO THE HOUSE

Monday, June 15, 1987

The Standing Committee on Public Accounts has the honour to present its

SEVENTH REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1986 and, in particular, Chapter 8, the comprehensive audit of the Agri-Food Program of the Department of Agriculture (the Department).

2. The cooperation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. At the same time as your Committee examined the administration of several important farm income support programs, the House of Commons debated the current crisis facing Canadian grain producers. In a crisis related to declining grain prices, certain of the findings of the comprehensive audit are directly relevant, such as the need to review the financial viability of the Western Grain Stabilization fund, in light of its deficit of approximately $850 million. In general, your Committee shared the Auditor General's concern that farm income programs need to be more carefully planned, funded and coordinated to ensure that adequate reserves are built up to assist farmers in times of greatest need.

Inadequate Response to Past Audits

4. In previous audits, in 1981 and 1982, the Auditor General made recommendations concerning the management of research operations, personnel planning, and the storage and disposal of toxic wastes and hazardous materials. In response to these recommendations, the Department committed itself to specific corrective actions. A document was filed with your Committee to this effect in January, 1983. One example of these commitments was the implementation, by year-end 1983, of formal guidelines for preparing, planning and selecting proposals for agricultural research. Yet, in his 1986 audit, the Auditor General found that this had not been done. Many other initiatives promised by the Department had not been completed, few had been implemented and even fewer were actually being used by program managers.

5. The Department provided a written progress report as of April 16, 1987 to your Committee and made further commitments in testimony to implement corrective measures by certain dates. The Department also offered to provide a second progress report for December 31, 1987.

6. Your Committee is concerned by the Department's slow progress in implementing the recommendations of earlier audits. This raises the question of effectiveness of the internal

audit and program evaluation functions within the Department. Furthermore, the appointment of a new deputy minister since the completion of the comprehensive audit has weakened the accountability process. Your Committee is also concerned about the response to the present audit. Accordingly, your Committee considers that the Department should provide additional information in its year-end progress report.

Recommendation

7. Your Committee recommends that the Department:

(a) **respond to your Committee in writing by January 29, 1988 on its progress as of December 31, 1987 in implementing the Auditor General's recommendations;**

(b) **include in this response the following:**

- **(i) for each recommendation repeated from the 1981 and 1982 audits, a re-statement of the commitments made to your Committee in 1983 and a full explanation of the action taken in each case;**
- **(ii) for each recommendation where a target date for corrective action was indicated in the evidence before your Committee (see Schedule I to this Report) and/or in the April 16, 1987 progress report, an indication of progress to date;**
- **(iii) a timetable of all planned corrective measures, extending to the period of the Auditor General's follow-up audit; and**
- **(iv) such additional information as requested in other recommendations in this Report; and**

(c) **provide a copy of its response simultaneously to the Auditor General, who is to assess it on behalf of your Committee, report his assessment to your Committee within a reasonable period and include the Department's response in his follow-up audit.**

Western Grain Stabilization (WGS) Concerns

8. While the Auditor General has drawn attention to the recent dramatic increase in the WGS deficit, from $175 million on December 31, 1986 to $850 million at present, your Committee noted that his purpose in doing so was to point out the need for better information and analysis in the administration of the WGS fund. This fund, which stabilizes grain prices by making payments to producers when prices fall below a five-year average, is based on levies from producers and the federal government. Both the levies and payouts are established by legislation.

9. The Auditor General informed your Committee that there was a need for better information on trends and external influences related to the WGS program. The recent decline in grain prices illustrated the importance of such information and the need for an early warning

system. In addition, the Auditor General called for a more thorough analysis of the financial implication of amendments made to the *Western Grain Stabilization Act* in 1984.

10. Your Committee also noted a disagreement between the Auditor General and the Department over a discretionary modification to the calculation of the WGS payout that increased the payments for the 1984-85 crop-year by $185 million. In this case, your Committee was informed that the Department's documentation was incomplete and the Minister was not fully informed by his officials about the exercise of his discretionary authority under the Act.

11. The Department informed your Committee that a review of the WGS program had been completed and proposals for changes in the financing of the program laid before Cabinet. This review included the Auditor General's recommendations.

Recommendation

12. **Your Committee recommends that the Department demonstrate improved analysis of information on trends and external influences in the administration of the WGS program and that the Minister ensure that prior to the exercise of discretionary authority under the *Western Grain Stabilization Act* he or she be provided with appropriate documentation. The Department is requested to include its update on this recommendation in its December 31, 1987 response to your Committee.**

Management of Research Operations

13. With respect to the Auditor General's finding of the need for national direction in the management of agricultural research, the Department stated that a recent re-organization had reduced the number of regional offices. This is intended to centralize decision making, so that research would not be duplicated in regions or research stations. The Department also stated that discussions were underway with the provinces, institutions and the private sector, to better coordinate agricultural research and develop a national framework for research priorities. The Department expected results from these initiatives by the end of the current fiscal year.

14. While recognizing the Department's progress, through negotiations with the provinces, in the implementation of the national agriculture strategy, which was recently signed by all Canadian ministers of agriculture, your Committee is concerned that the Department also respond to the specific recommendations of the Auditor General. These include improved management of human resources and the development of procedures in respect of: the transfer of new technology to the private sector, priority setting, resource allocation and management direction for research establishments.

Toxic Waste and Hazardous Materials

15. The health hazard posed by inadequate procedures and facilities for the storage and disposal of dangerous substances is a serious concern of your Committee. The Department stated that guidelines have been issued and 85 per cent of the facilities involved

have responded. New facilities are under construction, a training program has been started and a five-year strategy for the maintenance and renovation of storage buildings has been developed.

16. Your Committee endorses the Department's aim of 100 per cent compliance with proper procedures for the handling, transporting, storing and disposing of toxic wastes and hazardous materials. However, your Committee notes that this is one of the areas where the Auditor General's 1982 recommendations were not implemented (see paragraph 7 (b)(i) above) and will therefore seek evidence of substantial improvement in the Department's December 31, 1987 response.

Performance Indicators

17. The reporting of departmental performance to Parliament requires meaningful performance indicators, to indicate as clearly as possible the relationship between program activities and their end results. Good performance indicators facilitate accountability and may be used to improve management in the Department. In an earlier report (12th Report, 1st Session, 32nd Parliament, December 15, 1981), your Committee endorsed the reporting of actual performance information in Part III of the Estimates.

18. The Auditor General has expressed concerns about the Department's performance indicators, that they are deficient in terms of information the Department needs to manage well and would not be useful to Members of Parliament to understand the results of agricultural programs.

19. The Department agreed that its performance indicators required improvement, and outlined a list of revised performance indicators for the crop insurance program, which have been included in Part III of the 1987-88 Main Estimates. However, the Department had difficulty with matters such as the definition of a fair return to producers under the *Agricultural Stabilization Act*, or the disclosure of the level of commodity support compared to the significance of the commodity to the Canadian economy.

Recommendation

20. Your Committee recommends that the Department include, in its December 31, 1987 response to your Committee, examples, for each program, of specific, measurable indicators of performance. These indicators should show progress toward program goals.

Major Capital Projects

21. In the case of the acquisition of land for the research centre in London, Ontario, your Committee noted that the Department's project definition report called for a site 21.5 acres in size, but the Department purchased 67 acres. In addition, the Department paid $839,800 for the land, which was $405, 000 more than the appraised value.

22. In another case in London, Ontario, your Committee heard that the Department renewed the lease of the existing research laboratory for a four-year term and renewed it again for further year, pending completion of the new facility. The lease renewals were negotiated at the last minute and opportunities for cost savings were missed.

23. Your Committee noted that the Department has taken over from Public Works the responsibility for managing its own properties. In addition, the new procedure of increased ministerial authority and accountability may confer increased responsibility and accountability on the Department. The Department is currently negotiating with Treasury Board on this matter. In view of the lack of cost-consciousness revealed in the cases of capital project management before your Committee, it is incumbent on the Department to demonstrate that it has the capacity to handle these increased delegations of responsibility.

Recommendation

24. Your Committee recommends that the Department:

***(a)* include a status report on its negotiations with Treasury Board on increased ministerial authority and accountability in its December 31, 1987 response; and**

***(b)* demonstrate therein its capacity to accept these increased responsibilities and be cost-conscious.**

Crop Insurance

25. Your Committee noted the requirement under the *Crop Insurance Act* that the provincially-administered insurance plans be self-sustaining. The $261 million cumulative deficit in these plans underlined the Auditor General's concern that proposed premium rates be subject to actuarial review. The Department needs to ensure that adequate reserves are maintained to meet unforseen losses and that risks are fully assessed by recognizing long-term expected claims experience. The Department informed your Committee that it was acting on these recommendations in consultation with the Department of Insurance and an independent actuarial firm. Results are expected by the end of the year, and your Committee will monitor the Department's progress in this regard as indicated in its December 31, 1987 response.

SCHEDULE I

Item	Summary of Commitment in Committee Evidence	Applicable Auditor General's Recommendations
1.	Time frame for review of agricultural research: a joint document with the provinces by summer 1987, consultations with industry individually or in groups during early fall 1987 and regional consultations with industry in late winter 1988 (refer to Issue 18, page 36).	Research branch will clarify objectives and develop procedures in respect of technology transfer, priority setting, resource allocation and management direction to research establishments (recommendation 8.121).
2.	To incorporate the results of this review of agricultural research into the work plan of the Research Branch for fiscal year 1988-89 (refer to Issue 18, page 36).	*ibid.*
3.	In coming months, to achieve 100% compliance in all areas associated with the storage, handling and disposal of dangerous substances (refer to Issue 17, page 9).	Department will promulgate policies and procedures, identify dangerous substances, and provide appropriate facilities for storage, handling and disposal of these substances (recommendation 8.190).
4.	With respect to property management, completion of a facility inventory data bank in the summer of 1987 (refer to Issue 18, page 16).	Department will ensure that its facilities are acquired and its leases arranged with due regard for economy (recommendation 8.133).
5.	Submission to Treasury Board, by July 1987, of a new five-year capital plan (refer to Issue 18, page 16).	*ibid.*
6.	Negotiations with Treasury Board on increased ministerial authority and accountability to be completed and an agreement in place by fall, 1987 (refer to Issue 18, page 20).	N/A
7.	By the end of 1987, progress expected in crop insurance forecasting methodology and actuarial work, undertaken jointly with the Department of Insurance and a private actuarial firm; by November or December, a new set of definitions and a sophisticated rate-setting methodology to be in place (refer to Issue 18, page 38).	Crop Insurance Division will define what constitutes a self-sustaining insurance plan, make provision for adequate reserve funds, analyse future trends, and review the appropriateness of insurance rates every two or three years on the basis of formal actuarial review (recommendations 8.83 and 8.84).

A copy of the relevant Minutes of Proceedings and Evidence (*Issue Nos. 17, 18 and 22 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

REPORT TO THE HOUSE

Tuesday, June 30, 1987

The Standing Committee on Public Accounts has the honour to present its

EIGHTH REPORT

1. In accordance with its permanent Order of Reference contained in the Standing Orders of the House of Commons, your Committee has considered the Public Accounts of Canada for the fiscal year ended March 31, 1986, and, in particular, Volume I, Sections 2 and 3 concerning the Auditor General's Opinion and Observations on the Financial Statements of the Government of Canada.

2. The cooperation of the witnesses who appeared before your Committee is acknowledged and appreciated.

Need for a "Clean" Opinion

3. Your Committee observed that in the nine Opinions on the Government's financial statements since 1977, when the Auditor General was first given this mandate, there has never been a "clean" Opinion. Each year there have always been at least two Reservations. Some of these, such as the failure to consolidate Crown corporations and unrecorded liabilities, have been long standing and continue to be unresolved. In 1986 a new Reservation was introduced - the failure to provide for Crown corporation borrowings - which has resulted in a major difference of opinion between the Auditor General and the Government because of its stated accounting policies which the Auditor General considers to be inappropriate.

4. Your Committee recognizes that the issues associated with each Reservation are complex and have an impact on the size of the Government's deficit. It recognizes also that the Government wishes to resolve those issues raised by the Auditor General and to obtain a "clean" Opinion with no Reservations in the foreseeable future.

5. Your Committee has noted that in most cases the Auditor General is concerned about the inappropriateness of the stated accounting policies of the Government against which he must audit the financial statements. It is the view of your Committee that some of these accounting policies which are in dispute, should be examined by an independent professional accounting body which would recommend to the Government certain changes in accounting policy that would be acceptable to the Auditor General.

6. Your Committee endorses the work of the Public Sector Accounting and Auditing Committee (PSAAC) of the Canadian Institute of Chartered Accountants. In an earlier report, your Committee recognized the formation of PSAAC and encouraged the Government to maintain close coordination with it. (13th Report, First Session, 32nd Parliament, March 22, 1982.) Recently PSAAC issued a statement on "General Standards of Financial Statement Presentation for Governments" (November 1986). Twenty-six of the thirty-five

recommendations in this statement are consistent with existing Government practice and the remainder are being seriously considered. In your Committee's view, PSAAC should be invited by the Government to examine the accounting policies in question.

Recommendation

7. **Your Committee recommends that the Government invite the Canadian Institute of Chartered Accountants (CICA) to examine those accounting policies of the Government that cause concern to the Auditor General in his audit of the Government's financial statements or do not fully conform to CICA standards and to recommend changes so that a "clean" Opinion can be obtained.**

Failure to Provide for Crown Corporation Borrowings

8. In his first Reservation, the Auditor General reports that the Government has understated its reported liabilities and accumulated deficit by at least $900 million by not providing an allowance for borrowings by the Canadian Wheat Board (CWB) for sales to sovereign governments which have been experiencing difficulties in servicing their debts. In the Auditor General's opinion, CWB's assets, which are composed of receivables from debtor countries that are significantly in arrears, are worth less than its government - guaranteed debt and, therefore, a shortfall of $900 million, which is made up of accrued and unpaid interest on receivables for the period 1978 to 1983, should be booked as a liability in the Government's Statement of Assets and Liabilities.

9. The Government disagrees with the Auditor General's position. The Comptroller General stated before your Committee that no provision for borrowings is necessary because the Government expects that all moneys due from sovereign states will be collected eventually. He pointed out that mechanisms exist whereby the interest and post maturity interest are rescheduled and blended into new payment schedules and, furthermore, that the situation with the CWB is fully disclosed in a Note to the Government's financial statements.

10. Your Committee also heard arguments from both the Auditor General and the Comptroller General in support of their respective positions. These included the question of the collectability of receivables significantly in arrears; the difference in nature between sovereign loans and commercial loans; and the provision of a valuation reserve and its impact on the government's deficit and financial statements.

11. In the light of the aforegoing arguments, your Committee views this major difference of opinion between the Auditor General and the Comptroller General as a useful means for re-examining the Government's accounting policy with respect to borrowings of Crown corporations, where the Government guarantees the loans. However, as in a previous report, your Committee urges both parties to settle their differences in order that the Canadian people can have the proper confidence in the Government's financial statements (First Report, Second Session, 32nd Parliament March 13, 1984).

12. It is your Committee's view that where such guarantees are given to agents of the Crown and where the risk of loss or failure to repay, on the part of a debtor country or corporate entity, is very real, the Crown must be protected in all circumstances. Government's accounting policies should clearly enunciate the form of disclosure in the Government's financial statements where such risks are likely to occur.

13. It is questionable in this case of the sovereign loans of the Canadian Wheat Board whether the absence of a valuation allowance in the statement of Assets and Liabilities informs Parliament adequately of the potential risk and possible loss of assets to the Crown.

14. At the same time, it is not clear that limiting the provision for unpaid accrued interest to $900 million would be adequate to provide a fair presentation of the Government's financial position. Having heard the arguments on both sides of this issue, your Committee concludes that an independent objective opinion should be sought from a professional accounting body, such as Public Sector Accounting and Auditing Committee, as to how the financial statements of the Government of Canada can fairly present the financial position of the Government with respect to sovereign loans.

Recommendation

15. Your Committee, therefore, recommends that the Government obtain an independent professional opinion from the Canadian Institute of Chartered Accountants on the reporting of sovereign loans where the risk of loss to the Government of Canada is significant.

Failure to Consolidate Crown Corporations

16. The second Reservation of the Auditor General has been the subject of several previous reports of your Committee since 1978. It concerns the Government's failure in its accounting policies to include the assets, liabilities, revenues and expenditures of Crown corporations in the financial statements of the Government. This results in an incomplete summary of the full nature and extent of the financial affairs and resources for which the Government is responsible. Furthermore, in 1986, the Auditor General noted the impact on the Government's overall deficit of the significant losses of two Crown corporations - Canada Deposit Insurance Corporation and Petro-Canada - which are outside of the government's accounting entity.

17. Your Committee recognizes that the consolidation of Crown corporations in the Government's financial statements is a complex subject because it involves so many other accounting issues such as fixed assets and revenue accruals. However, your Committee heard progress reports from the Comptroller General that substantial research work on consolidation was underway by the Office of the Comptroller General and by the Canadian Institute of Chartered Accountants and which will be reported to your Committee in the fall of 1988. Your Committee also noted that improvements in the reporting of Crown corporation information have been introduced in the 1986 Public Accounts; the Comptroller General stated that additional improvements will be made in the 1987 Public Accounts. Your Committee will continue to monitor the progress of this work.

Recommendation

18. Your Committee recommends that the Office of the Comptroller General provide it with a progress report on the consolidation of Crown corporations in the financial statements of the Government by September 30, 1988.

Need for Improved Financial Reporting for Parliament

19. Your Committee supports and encourages the work done by the Offices of the Auditor General and the Comptroller General and the Canadian Institute of Chartered Accountants on improved financial reporting for Parliament. In particular, your Committee notes the significant findings of the Auditor General's Federal Government Reporting Study (FGRS) of June 1986 and endorses the need for a succinct annual financial report for parliamentarians and other users of government financial information.

20. Your Committee welcomes the favourable response to the Federal Government Reporting Study (FGRS) by the Comptroller General and his objective of improved financial reporting. It supports his current initiatives that include improved disclosure in Part III of the Estimates. Your Committee will monitor the progress made by the Office of the Comptroller General in its research work to improve Volume I of the Public Accounts as suggested in the FGRS Report, to improve the reporting of tax remissions, fixed assets, government reporting entity, and the timeliness of the Public Accounts.

Recommendation

21. Your Committee recommends that the Office of the Comptroller General provide it with a progress report with respect to the Federal Government Reporting Study recommendations by September 30, 1987.

22. Finally, your Committee acknowledges the work of the Public Sector Accounting and Auditing Committee in striving to establish for governments at all levels sound accounting standards and practices.

23. Your Committee requests a Government response to its recommendations in paragraphs 7 and 15 above pursuant to S.O. 99(2).

24. A copy of the relevant Minutes of Proceedings and Evidence *(Issues Nos. 19, 21 and 23 which includes this report)* is tabled.

Respectfully submitted,

AIDEEN NICHOLSON,
Chairman

REPORT TO THE HOUSE

Tuesday, June 30, 1987

The Standing Committee on Public Accounts has the honour to present its

NINTH REPORT

1. In accordance with its permanent Order of Reference contained in the Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1986 and, in particular, paragraphs 14.19 to 14.36, the audit of the Radar Modernization Project (RAMP) of the Department of Transport.

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. In February of this year, your Committee considered the latest annual report from the Treasury Board Secretariat on the cost control of major capital projects. This presented data on the Government's project approval process and indicated progress in controlling the costs of these projects since the current policy was adopted in 1980. Your Committee suggested improvements in this document.

4. In March and April, your Committee then considered one such major Crown project, the Radar Modernization Program (RAMP) of the Department of Transport. In two public meetings the major issues associated with RAMP were reviewed. Arising from the Auditor General's special audit of this capital project, your Committee dealt with inadequacies in the requirements definition process, the benefit-cost studies and the impact of the Treasury Board Secretariat's cost control process.

5. Your Committee noted that RAMP has been the subject of three successive benefit-cost analyses and that the Department's assessment of the latest of those studies was completed concurrently with the Committee's last meeting on this subject. The Auditor General was therefore not in a position to comment in detail on this latest benefit-cost analysis. Your Committee requested the Auditor General to undertake such an assessment and will consider his findings when these become available. Your Committee wishes to put the various parties on notice that a public meeting will be held on this subject with Parliament resumes in the fall and that your Committee will consider a more detailed report to the House at that time.

6. A copy of the relevant Minutes of Proceedings and Evidence *(Issue Nos. 10, 16, 20 and 23 which includes this report)* is tabled.

Respectfully submitted,

AIDEEN NICHOLSON,
Chairman

APPENDIX D

REPORT ON QUARTERLY REPORTS

REPORT ON THE AUDIT OF QUARTERLY REPORTS ON CROWN CORPORATIONS TABLED BY THE PRESIDENT OF THE TREASURY BOARD

Introduction. The Financial Administration Act requires the President of the Treasury Board to lay quarterly reports before each House of Parliament concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to Part XII of the Act.

These quarterly reports allow Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing it, within the relevant statutory deadlines, with information required under the Financial Administration Act. Accordingly, each quarterly report is required to indicate the annual reports and the summaries of corporate plans, capital budgets and operating budgets (and amendments to them) that were to be tabled before each House during the quarter; the time at, before, or within which they were required to be tabled; and the time they were actually tabled.

Scope. I am required by subsection 153.1(2) of the Financial Administration Act, to attest to the accuracy of the information contained in the quarterly reports on Crown corporations tabled by the President of the Treasury Board. Accordingly, I have examined the quarterly reports for the four quarters indicated below:

	Tabled in Parliament	
Quarter Ended	House of Commons	Senate
30 June 1986	1 October 1986	2 October 1986
30 September 1986	17 November 1986	25 November 1986
31 December 1986	20 February 1987	10 March 1987
31 March 1987	21 May 1987	26 May 1987

My examination included a review of the systems and procedures used by Treasury Board to monitor the tabling of the summaries and annual reports in each House of Parliament, a verification of the information contained in each of the quarterly reports, and such other tests and procedures as I considered necessary in the circumstances.

Conclusion. I have concluded that the four quarterly reports listed above contain all the required information about the timing of tabling, by the appropriate ministers, of Crown corporations' annual reports and summaries (and amendments to them) of corporate plans, capital budgets and operating budgets, and in my opinion, the information contained in the quarterly reports is accurate in all significant respects.

Kenneth M. Dye, F.C.A.
Auditor General of Canada

OTTAWA, 28 August 1987